VORYS

Publications

The Evaluator Winter 2023: Valuation Analysis

Related Attorneys

Nicholas M.J. Ray
Andrew E. DeBord
Lauren M. Johnson
Michael Mangan
William G. Noe
Lindsay Doss Spillman
Megan Savage Knox
Hilary J. Houston
Steven L. Smiseck
Anthony L. Ehler
David A. Froling
Scott J. Ziance
Steven R. Rech
Adam S. Hamburg
Jacinto A. Núñez
Michael P. Oliverio

Related Services

Property Tax Management
Real Estate
Taxation

AUTHORED ARTICLE | Winter 2023

This article appeared in the Winter 2023 edition of *The Evaluator*.

Valuation Headlines

Arizona Appeals Court Allows Non-Taxable, Intangible Assets to Increase Taxable Value of Power Plant

Mesquite Power, LLC v. Dep't of Revenue, Ariz. Ct. App., No. 1 –CA-TX 22-0002 (Dec. 12, 2022).

Intangible assets, like leases, contracts and other business agreements, that benefit the business operated at a property are non-taxable under Arizona property law. These agreements are considered intangible property. But, power plants are difficult properties to value for tax purposes. The real property and fixtures are constructed to generate business income. Identifying and valuing intangible as distinct from tangible property is different. An Arizona taxpayer must overcome the presumption that the taxing authority's valuation was excessive when derived by standard appraisal methods and techniques.

The Arizona Department of Revenue successfully argued that a power purchase agreement (PPA) between the plant owners and a utility should be considered in valuing the real property. A property's PPA is instructive in determining the value of the property because it influences what a willing buyer would pay for the real property. The appeals court agreed.

The property owner, Mesquite Power, LLC, purchased the subject property with an existing PPA for more than $550 million. Its appraiser valued the real property using the cost approach at $105 million. The appeals court focused on this difference – a wide gap – and found that Mesquite had to explain the difference.

According to the court, even if the PPA holds value that is separate and distinct from the real property, Mesquite failed to explain the $400 million gap. At a 30,000 foot level, this makes intuitive sense. A recent, arm's-length sale of the subject property is good evidence of value.

Moreover, some states also allow an assessor to consider an existing PPA in determining the fee simple value of a power plant even if intangible property is not taxable. Thus, Arizona is not alone in giving weight to an existing PPA.

The appeals court found that its treatment of the low-income housing tax credits (LIHTC) program was analogous to this case. It had previously affirmed giving consideration to properties within the LIHTC program because they are subject to deed restrictions that result in lower rents and lower values. It agreed that these agreements were intangible and untaxable; nonetheless, no willing buyer would ignore the deed restrictions when establishing a purchase price. The value of a LIHTC property would be reduced due to an intangible agreement i.e., deed restrictions.

Applying what it described as parallel reasoning, the appeals court held that a willing buy would consider the PPA's impact on the economic viability of the plant in determining the value of the real estate. It concluded that because the PPA influences the purchase price a willing buyer would pay for the real property, the proper value of should reflect its (the PPA's) effect. It upheld the department's value.

California Appellate Court Affirms Board Decision That Ignored Cost Comparables Landing Another Blow to Dark Store Theory in the State

Walmart v. County of Placer CA3, California Court of Appeals Third District Court No. C093835 (Oct. 17, 2022, Unpublished).

The "dark store theory" of valuing real property was at issue in the appeal of two Walmart stores in Placer County, California last year. The Placer County Assessment Appeals Board (Board) rejected the taxpayer's argument that big-box retailers were experiencing economic obsolescence. The Appellate Court upheld the Board's decision.

Across the country, big-box retail stores, behemoth department stores, hardware sellers and other outlets with more than 50,000 square feet of space have been closing and remaining vacant (aka going dark) at an increasing pace. As economic competition has shifted to online shopping, some of the nation's largest retailers have gone out of business or moved online. The dark store theory of property valuation addresses this vacancy in property tax valuation cases by quantifying it as economic obsolesce.

The legal issue at the heart of the theory is how to properly value the fee simple interest of a property within a rapidly changing market. Most states require assessments to be based upon the unencumbered, fee simple, market value of the property i.e., value of the real property, not the actual leases or current occupancy (called the leased fee value). Taxpayers argue that when valuing big-box properties, an appraiser should consider vacant or "dark" stores in the market to measure economic obsolescence. Assessors do not like this theory because it results in lower values and lower taxes.

At the Board hearing, the parties primarily relied upon the cost approach due to limited comparable sales and leases. Walmart did not present an income approach and agreed that the sales comparison approach had limited application. Walmart presented its own study of economic obsolesce and depreciation as a "third step" in the cost approach. In contrast, the assessor relied solely upon Marshall and Swift depreciation tables and gave no deduction for the economic obsolescence.

The Board rejected Walmart's study because it relied on former Sam's Club stores that were vacant and had significant deed restrictions on the use of the properties. These "cost comparables" were, in the Board's estimation, economically inferior. The Board also relied upon the Marshall and Swift depreciation tables and sustained the assessor's value. The California Court of Appeals affirmed the decision.

The standard of review required the taxpayers to overcome the presumption that the assessor properly assessed the value of the property. The Appellate Court focused on whether Walmart could show that using the cost approach to value was contrary to law. It concluded that it was not. The Appellate Court also noted that the Board did not apply the cost approach incorrectly. The court rejected Walmart's attempt to invoke a different rule related to the application of the cost approach because it did not properly assert it in the original appeal. Nevertheless, the decision leaves little room for that argument's success.

Walmart asserted that by not completing an essential 'third step' in the cost approach, determining obsolescence, the Board did not apply the cost approach at all. The Appellate Court concluded that under either standard of review, Walmart's challenge to the valuation lacked merit.

Of significance, the Appellate Court found that the issue of the unencumbered fee interest was not necessary to reach its conclusion. It concluded that the fee simple argument "does not relate to the cost approach." The court seemed to indicate that a property's leased fee value is only at issue if the income approach is applied. Appraisers will generally disagree if this is what the court means. Establishing the interest to be appraised has traditionally been seen as relevant to all three approaches.

The decision takes air out of the dark-store theory of valuation in California. A taxpayer might try to assert that using the cost approach to value without considering other approaches violates a different rule Walmart could not assert in this case, but to limited effect. Sales are rare and the wide range of values often support both the taxpayer and assessor. Perhaps a taxpayer could persuade a different board that the decision is limited due to the inferior cost comparables used in Walmart's study on a case-by-case basis.

The Appellate Court was not persuaded that the Board did anything wrong in relying on the Marshall and Swift depreciation tables, which do not address market-based economic obsolescence. This sets a high hurdle for taxpayers. Measuring the economic obsolescence big-box retailers are experiencing by conducting its own market study did not overcome the hurdle.

Colorado Supreme Court Hears Marathon Oral Arguments in Coordinated Legal Cases Seeking Off Cycle Revaluation for Properties Impacted by COVID-19 Pandemic and Related Government Restrictions

In the Colorado Supreme Court - *Larimer County Board of Equalization et al. v. Boeing Drive Investments LLC et al.*, Case Number 22SC800; *Educhildren LLC et al. v. County of Douglas Board of Equalization et al.*, Case Number 22SC799; *MJB Motels LLC v. Jefferson County Board of Equalization et al.*, Case Number 22SC798; and *Hunter Douglas Inc. v. City and County of Broomfield Board of Equalization et al.*, Case Number 22SC797.

The Colorado Supreme Court recently heard oral arguments in eleven coordinated cases brought by property owners seeking revaluation of their properties in 2020, an off cycle year. The Court agreed to hear all of the cases together and bypass the appeals court in four of the cases, as the outcome will affect properties statewide and set important precedent.

The property owners, whose cases are being coordinated through the same law firm, claim that the COVID-19 pandemic and government restrictions affected their properties. Under Colorado's statutory scheme, an assessor may perform revaluations for an intervening year where there are clerical errors, an incorrect value or to adjust for an unusual condition. The property owners contend that the COVID-19 pandemic and government restrictions constituted "unusual conditions" under Colorado's valuation statute. These unusual conditions, the property owners argued, required assessors to revalue the properties in 2020, before the usual start of the revaluation cycle in 2021. The county and assessors argued that no intervening year revaluation was permissible because the unusual conditions did not exist on the relevant assessment date, January 1, 2020.

At oral argument, the question of whether county tax assessors can consider unusual conditions occurring after the January 1, 2020 assessment date was a threshold issue for the court. The justices also appeared to have multiple views on whether the pandemic and associated regulations constituted an unusual restriction. The assessors and counties argued that the government restrictions and virus did not affect the use of the land. The justices seemed inclined to agree that the pandemic may not be considered an act of nature that affected the land, but whether the government restrictions affected the use of the land may be a "much closer case." Finally, the justices commented that if taxpayers could get a reassessment in real time – i.e. a reduction to the 2020 tax bill for acts that occurred in 2020 – it would cause confusion for Colorado's valuation scheme, which sets assessments based on lagging values.

Indiana Tax Board Reduces Valuation of Cabela's Store

Cabela Wholesale LLC, et al v. Lake County Assessor, Indiana Tax Court Nos. 45-023-18-1-4-00230-20, et al (Sept. 26, 2022).

The Lake County Assessor's office assessed the retail property at $15.7 million in 2018, $16.0 million in 2019 and $15.8 million in 2020. Cabela's asserted that the value should be $8.2 million in 2018 and $8.5 million in 2019 and 2020.

In its analysis, the Indiana Board of Tax Review (IBTR) first addressed the issue of the burden of proof. Due to Cabela's admission, the IBTR determined that Cabela's had the burden for 2018. However, because the evidentiary hearing was held prior to the repeal of the "burden shifting statute," the assessor had the burden for 2019 and 2020. In reviewing the appraisal evidence submitted both by Cabela's and the assessor, the IBTR determined that the assessor's appraisal (after adjustments by the IBTR), which utilized the income approach, was the most persuasive evidence of the property's market value in use for 2018. In arriving at this conclusion, the IBTR determined that the assessor's appraiser utilized better comparable properties both in the income and sales comparison approaches to value the subject property. In determining the valuation for 2019 and 2020, the IBTR found that neither party met its burden and the assessments must revert to the value determined for 2018.

Iowa Supreme Court Reinstated Polk County's Original Assessment of Corporate Office Buildings

Nationwide Mutual Insurance Co. v. Bd. of Review, Iowa Supreme Court, Case No. 20-1290 (December 16, 2022).

The Iowa Supreme Court reinstated Polk County's original valuation of Nationwide Mutual Insurance Company's (Nationwide) corporate office buildings in Des Moines, Iowa. The Supreme Court reversed the court of appeals' decision that found the evidence presented by Nationwide was more probative and justified a reduction in value.

In reviewing the court of appeals decision, the Supreme Court first cited Iowa Code, which establishes the sales approach as the preferred method of determining valuation. Despite this preference, the Court stated that when the market value can't be readily established under the sales approach, the assessor may determine the value of the property using other uniform and recognized appraisal methods. In reversing the court of appeals, the Supreme Court found that the appeals court "grafted too rigid a standard" for the sales approach. The Court determined that the valuation could not be determined by the sales approach and that it was necessary to consider other factors to determine the value of the office properties. The Court noted that all four expert appraisals developed all three approaches to value – cost, sales and income – and that the district court properly considered other factors to determine value, similar to how all the expert appraisers arrived at their final values in their appraisals. In affirming the district court's valuation, the Supreme Court reinstated the original values of $87,050,000 for 1100 Locust and $44,910,000 for 1200 Locust for tax years 2017 and 2018.

Michigan Tax Tribunal Reduces Valuation of Hotel Due to Market Saturation from Increase in Newly Constructed Hotels in the Area

Wyoming Hospitality Inc. v. City of Wyoming, Michigan Tax Tribunal No. 20-00050 (Sept. 27, 2022).

This matter involved a hotel built in 1997. For 2020, the property was assessed at $9.3 million. The owner sought a reduction in value to $8.1 million based on a change in market.

The owner, Wyoming Hospitality, argued that new construction near the subject had created a saturated market. Specifically, the owner noted that there were 16 existing or proposed hotels under construction, which would add an additional 1,716 rooms. Eleven additional properties were in the planning stages, which would add 1,033 more rooms. Occupancy of the subject hotel decreased between 2017 and 2019. Its REVPAR also was down 9.1%. The owner offered supporting appraisal evidence at the $8.1 million value.

The City of Wyoming argued through appraisal that the property was located in a superior market and was undervalued. The city therefore asked the tribunal to find a value of $11.3 million.

Upon review, the tribunal found that a reduction in the property's value to $8.1 million was warranted, given the decline in occupancy rates since 2017 and changes in market competition. The Tribunal also rejected the city's proposed $2 million increase in valuation. The Tribunal found that city's argument was unpersuasive because "current influx of additional new rooms to compete with existing rooms would logically be a decrease [in value] until the occupancy increased."

Missouri Tax Commission Finds That LIHTC Property Used Exclusively for Charitable Purposes is Exempt from Real Property Taxes

Westward Development, Inc. v. Tracy Baldwin, Assessor, Clay County, Missouri Tax Commission, case number 21-32153 (Oct. 7, 2022).

At issue is Missouri's real property tax exemption for property "actually and regularly used exclusively . . . for purposes purely charitable, and not held for private or corporate profit." The Clay County Board of Equalization (BOE) denied the property owner's request for real property tax exemption for tax year 2021 and found that the subject property's true value was $1,905,500. The property owner appealed the BOE decision.

The subject property consists of 63 HUD rental units used for low-income, elderly and handicapped residents with less than $5,000 in assets. The property owner is a nonprofit Missouri corporation. The property provides handicapped equipment and supplemental assistance as needed to its residents, as well as social programing and miscellaneous services. Residents are required to pay 30% of their income as rent.

To qualify for the charitable real property tax exemption, property owners must satisfy a "three-part test" that was established in *Franciscan Tertiary Province of Missouri, Inv. v. State Tax Commission*, 566 S.2d 213, 224 (Mo. banc 1978). The first prong requires the property be "actually and regularly used exclusively for purposes purely charitable." "Exclusively" has been interpreted to mean primarily. The Tax Commissioner held that the property owner's evidence satisfies this prong in that the subject property is used exclusively for charitable purposes as housing for low-income, elderly and handicapped individuals. The second prong requires the property be owned and operated on a nonprofit basis. The Tax Commissioner held that the property owner, as a nonprofit owner, satisfies this prong.

Finally, the third prong of the test requires that the dominant use of the property be for the "benefit of an indefinite number of people and must directly or indirectly benefit society generally." The BOE argued against this prong of the test insisting that the benefit conferred is limited to the residents living at the subject property and that the selection process is too narrow to broadly benefit society. The property owner countered by arguing that the benefit is to "'low income and handicapped tenants' who could be an indefinite number" and accordingly society in general benefits from the property's use.

The Tax Commissioner, citing to *Evangelical Ret. Homes of Greater St. Louis, Inc. v. State Tax Comm'n,* 669 S.W.2d 548 (Mo. banc 1984), held that a charity may restrict the class of humanity being served and still be public. The fact that the subject property is limited to low-income, elderly and handicapped residents does not disqualify it from benefiting the public generally. The Tax Commissioner held that the housing services benefit an indefinite number of persons and the third prong of the test for real property tax exemption is satisfied. Accordingly, the Tax Commissioner determined that the subject property is exempt from real property taxes as property used exclusively for purposes purely charitable.

New York Appellate Court Upholds Supreme Court's Decision in Dispute over Mall's Valuation

Matter of Colonie Ctr. v. Town of Colonie, 2022 NY Slip Op 06045, Sup. Ct., Albany County 2022 (Decided October 27, 2022)

Colonie Center is an enclosed shopping mall located in a suburb of Albany, New York. The property sold in an arm's length transaction for $106,574,600 in April of 2013. For the 2017-2019 tax years, the town's assessments for the property were $65,000,000 and the corresponding market values were $96,296,296, $97,744,361 and $101,167,315, respectively. The property owner initiated RPTL 7 proceedings and sought reductions of the town's assessments for the 2017-2019 tax years. To support their petitions, the petitioner provided appraisal evidence and testimony of an appraiser that opined to market values of $72,200,000, $68,000,000 and $64,000,000 for the tax years at issue. Meanwhile, to support their original assessments, the town provided appraisal evidence and testimony from an appraiser that opined to market values of $98,564,000, $100,087,000 and $101,894,000 for the tax years at issue.

The Supreme Court ultimately determined that the property owner had failed to prove that the mall was overvalued by the town for the tax years at issue and dismissed the petitions. On appeal, the appellate court was tasked with determining whether the property owner had established, by a preponderance of the evidence, that the property was overvalued after weighing the entire record. First, the appellate court agreed with the Supreme Court that the April 2013 sale for the property was relevant and compelling evidence of the property's fair market value for the tax years at issue. Therefore, the appellate court concluded that the property owner's appraiser's "dramatically" lower valuations were significantly undermined due to the fact that he disregarded the April 2013 sale and failed to demonstrate that the sale was abnormal.

Second, the appellate court agreed with the Supreme Court's rejection of the owner's appraisal because of a flawed income capitalization approach. Both of the appraisers relied on the income capitalization approach to value the mall since that approach is recognized as the best approach for valuing income-producing shopping malls. However, the appellate court found that the property owner's appraiser incorrectly relied on market rents instead of the actual rents of the property. Moreover, the appellate court was not persuaded by the property owner's claim that the town's appraisal amounted to a leased fee valuation because the town's appraiser also utilized an occupancy cost ratio to test the actual rents of the property against the market to prove that they were reflective of market value.

Additionally, the appellate court agreed with the Supreme Court that the town's appraiser concluded to more credible and well-supported vacancy and capitalization rates in their appraisal report. The appellate court consistently found that the property owner's appraiser relied on national trends and unidentified comparables throughout his report. Considering the record as a whole, the court found no error in the Supreme Court's rejection of the owner's appraisal and dismissal of the petitions.

Tennessee State Board of Equalization Retains Local Board's Valuation for an Assisted Living and Independent Living Facility

In re: Legacy II Property Co LLC/Rakshan Residency LLC, Tenn. St. Bd. of Equalization, Appeal Nos. 138374/138480 and 138375/138481 (Sept. 23, 2022)

In appeals brought by both the assessor and the taxpayer, the Tennessee State Board of Equalization (BOE) found that neither party had proved, by a preponderance of the evidence, that the values for tax year 2021 for an assisted living facility and an independent living facility should be revised.

In reviewing the proceedings at the first level of appeal, the BOE noted that the property was comprised of two separate buildings located in an economically depressed area. While the taxpayer had purchased the property in a sale six months past tax lien date, the sale was a foreclosure auction and under Tennessee law, a type of distressed sale that could not be used for establishing value.

For the assisted living facility, as of the date of valuation, the property was in need of substantial repair and renovation as it had been vacant and suffered from extreme vandalism. For the independent living facility, the BOE recognized that the property was modular construction.

The BOE rejected the assessor's valuation approaches under all three methods – sales, income, and cost – for both properties. The BOE highlighted that the assessor admitted calculation errors wherein the assessor failed to correctly account for reimbursements on both properties that would have changed his ultimate value conclusion. The BOE also found fault with the assessor, as he did not recognize that the independent living facility was modular construction.

The BOE also rejected the taxpayer's evidence finding that the comparable sales it relied upon were too remote from tax lien date or were of properties in condition not comparable to the subject property. Ultimately, the BOE upheld values as established by the local board.

Tennessee State Board of Equalization Affirms That the Income Approach is the Proper Method to Value a Nursing Home, but Rejects Taxpayer's Appraiser's Income Approach Containing Excessive Deductions

In Re: National Health Investors, Tenn. St. Bd. of Equalization, Appeal No. 130069 (Nov. 16, 2022).

The Tennessee State Board of Equalization (BOE) rejected a taxpayer's income approach to valuing a nursing home property and maintained the local board's valuation for tax year 2020, 2021 and 2022. The taxpayer challenged the assessment for a 79-unit skilled care facility that was licensed for 115 beds. The individual rooms had no kitchens, had a shared shower facility and the funding for the nursing home was primarily through Medicare reimbursement.

The taxpayer presented an income approach to value in which it reduced its net operating income by 75% as it attributed 75% of the income for skilled nursing to nursing services and food. Said another way, the taxpayer attributed only 25% of the income to rent. The taxpayer's valuation also deducted the COVID relief funds received during the pandemic.

The assessor's representative prepared a cost approach to value, which the BOE criticized as being inapposite to case law on valuing nursing homes. The assessor also prepared an income approach with a significantly smaller deduction for services and no deduction for COVID funds.

In finding that the taxpayer's valuation analysis was unreliable, the BOE noted that the 75% services deduction was excessive and not recognized in any case law. Moreover, the BOE noted that such a deduction, in addition to the deduction of expenses constituted "double dipping." The BOE also held that although the COVID funds were granted under special circumstances, a deduction was inappropriate because they were, in fact, income.

West Virginia Supreme Court Finds That the Trial Court Erred in Reversing a County Board of Assessment Decision Where Taxpayer Evidence Did Not Prove Error in the Assessor's Cost Approach

Berkeley County Council v. Government Properties Income Trust, LLC, et al., WVA Sup. Ct. No. 20-1019 and 20-1022 (Nov. 10, 2022).

At issue in these consolidated matters was the value of two properties owned by separate and unrelated entities. Both properties were valued by the county assessor for tax year 2019 using the cost approach.

The first property, owned by Government Properties, was assessed at a market value of $4,212,200. Government Properties filed an appeal to the Board of Assessment (BOA) appeals. There, Government Properties submitted an appraisal opining a value of $2,150,000. The owner argued that the property suffered considerable obsolescence. The BOA affirmed the assessor's value. On appeal to the Circuit Court, the court found in favor of Government Properties, stating that the owner's appraisal was superior to the assessor's

The second property was owned by Martinsburg IRS OC and was valued at $26,940,000. The owner filed an appeal to the BOA appeals. There, Martinsburg submitted a $7,240,000 appraisal using a hybrid income and sales comparison approach to value. The Board affirmed the assessor's cost approach to value. On appeal, the Circuit Court fully adopted the owner's value.

The West Virginia Supreme Court reversed the Circuit Court's decision in both cases. The Supreme Court noted that, in each case, the assessor based the assessment solely on the cost approach because the property owners did not respond to information requests that would enable the assessor to utilize either the cost or income approaches to value. The Supreme Court found that, under West Virginia law, the cost approach assessments were therefore presumed correct, and the owners had the burden to show how the cost approach assessment was erroneous. In both cases, the owners failed to offer any evidence to prove that the assessor's cost valuations were not supported by substantial evidence or were otherwise in contravention to law. The only thing the owners did was to propose alternative methods of valuing the property using methodology not applied by the assessor. This strategy was insufficient to overcome the presumption that the assessor's cost methodology was flawed. Therefore, the assessor's value should have been upheld at the Circuit Court level.