

BEFORE THE MONTANA TAX APPEAL BOARD

Voegele's Inc.,

Appellant;

v.

**State of Montana,
Department of Revenue,**

Respondent.

CASE No: PT-2015-13

**Findings of Fact,
Conclusions of Law, Order,
and Opportunity for Judicial
Review**

Before the Board is Appellant Voegele's, Inc.'s appeal from the Cascade County Tax Appeal Board's decision to deny their appeal of Respondent State of Montana, Department of Revenue's (DOR), valuation of Voegele's property. The property is located at 1000 3rd Street N.W., Great Falls; geocode 02-3015-02-1-01-4-0000; legal description C and W Addition, S02, T20 N, R03 E, Block 001, Lot 001, and is commonly known as the Kmart property.

ISSUE

1. The issue before the Board is whether the DOR correctly determined the value of the Kmart property for property tax purposes when it used standardized market rental rates instead of using Voegle's actual rental income and expense numbers.

BEFORE THE MONTANA TAX APPEAL BOARD
Voegele's Inc. v. DOR

2. Appellant argues that the market value of the Kmart property is \$1,600,000. Appellant argues that DOR should use taxpayer's actual rent and expense figures because the property is encumbered by a long-term lease that locks the actual rent well below current market rent and no purchaser would pay more for the property than the net present value of the expected rate of return from the property's income stream.
3. DOR argues that all commercial rental properties statewide are valued similarly using regional market rental rates, as determined by the DOR, to reflect the true market value of the property and ensure that DOR equalizes values across the state without rewarding or penalizing any individual commercial property owner for their business acumen. DOR has assessed a value of \$4,204,800 for the Kmart property as of January 1, 2014.

FINDINGS OF FACT

4. The Board conducted a hearing on April 12, 2016 at 10:00 AM at 600 N. Park Ave., Helena at which the following were present:
 - a. Merlin Voegele, representing Voegele's Inc.;
 - b. Michele Crepeau, representing DOR;
 - c. Brenda Ivers, DOR appraiser for Cascade County, as witness for DOR;
 - d. Jason Boggess, DOR region 2 manager, as witness for DOR.
5. The following exhibits were introduced and admitted:

BEFORE THE MONTANA TAX APPEAL BOARD
Voegle's Inc. v. DOR

a. by Voegle's Inc.;

Ex. 1 – original Kmart lease from 1974,

Ex. 2 – discovery responses from DOR,

b. by DOR;

Ex. A – assessment packet (sealed),

Ex. F – Staples property record card (sealed),

Ex. G – ShopKo property record card (sealed).

6. DOR did not introduce exhibits B, C, D, or E.
7. Mr. Voegle testified that Voegle's Inc. purchased the Kmart property in 1999, subject to the existing lease and three lease modifications, entered into between Voegle's predecessor(s) in interest and Kmart between 1972 and 1974. (MTAB Hrg. Transcr. 4:21-23; Ex. 1.) The initial lease term was for twenty-five years, but the lease granted Kmart unilateral options to renew the lease for nine successive five-year terms without any escalation to the rental amount as determined by the 1972 lease. (Id. 4:17-24; Ex. 1.) If Kmart exercises all of its options to renew, the lease will remain in effect through 2044. (Ex. 1.)
8. The lease also grants Kmart the right to sublease the Kmart property without landlord approval. (MTAB Hrg. Transcr. 4:25; 5:1; Ex. 1.) Mr. Voegle testified that he believes Kmart will likely exercise all of its options to renew, because if Kmart no longer occupies the property it would likely

BEFORE THE MONTANA TAX APPEAL BOARD
Voegele's Inc. v. DOR

be able to sublease the property at the higher market rental rate and keep that difference. (Id. 5:1-6; Ex. 1.)

9. Mr. Voegle testified that Voegele's Inc. paid \$1,600,000 for the Kmart property with full knowledge of all the lease terms, but concluded that the purchase price was appropriate given the annual base rental amount of \$183,000 per year plus bonus rent for gross sales in excess of \$8,000,000 per year. (Id. 5:6-11; 6:1-4.) Mr. Voegle testified that Kmart has paid bonus rent every year, but the amount has decreased from close to \$50,000 a year when they purchased the property to under \$10,000 for the recent years. (Id. 6:4-7.)

10. Mr. Voegle testified that the Kmart property has been a good investment and he believes that their purchase price of \$1,600,000 would still reflect the current fair market value of the property because income-producing properties are typically valued on the current and predictable income stream and the income of \$183,000 per year has not changed since Voegle's, Inc. purchased the property in 1999 and will not change until 2044. (Id. 5:9-15.) Mr. Voegle concluded that any rational purchaser of the property would not pay more than the net present value of the predictable future income stream, which using the DOR's capitalization rate and the Kmart property's actual income and expense figures, calculated out to between \$1,500,000 to \$1,600,000. (Id. 5:19-23; 6:4-8.)

11. Mr. Voegle testified that if the Kmart property was not subject to the lease the DOR's assessed value is likely an accurate reflection of fair market value. (Id. at 8:20-21.) Mr. Voegle testified that no current purchaser would pay \$4.2 million for the Kmart property because it is

BEFORE THE MONTANA TAX APPEAL BOARD
Voegele's Inc. v. DOR

encumbered by the lease. (Id. at 12:4-8.) Upon cross-examination regarding the DOR's valuation Mr. Voegle replied "if you value the property as what it would bring a willing buyer and willing seller, you're not going to find one that would pay that kind of value. It's all encumbered by the lease. It may have value to someone, to the lessee, but certainly not to the owner." (Id. 12:4-8).

12. Brenda Ivers, the lead appraiser out of the Great Falls DOR office for Cascade County Region 2, testified that she has worked for the DOR for 26 years, and in her current position her duties include typical appraisal reviews of residential, construction and commercial properties as well as handling more diverse and complex properties. (Id. at 13:19-20; 14: 8-11.) Ms. Ivers testified that when the DOR is in the process of making final determinations of value, she reviews the properties to ensure the DOR is consistently applying the same appraisal theory to similar properties. (Id. at 14:11-14.) Ms. Ivers testified that she works with the income and expense data that goes into the modeling process to ensure that that data is accurate because those models determine how the DOR values a significant percent of all income producing commercial properties. (Id. at 14:14-16.)
13. Ms. Ivers described the location of the Kmart property as one of the primary commercial areas in Great Falls, and described the improvements as basic concrete block box-store construction, built in 1974 for its only tenant to date, Kmart. (Id. at 15:6-17.)
14. Ms. Ivers testified that the DOR used the same market based rental income model to value the Kmart property that the DOR used to value

BEFORE THE MONTANA TAX APPEAL BOARD
Voegelé's Inc. v. DOR

other similarly situated commercial properties. (Id. at 17:10-19.) Ms. Ivers identified six other large retail stores in the surrounding six-block area that the DOR valued using the same rental income model that it used to value the Kmart property. (Id. 18:12-21; Ex. A.)

15. Ms. Ivers described that within the rental income model the DOR has three rent ratings to reflect the overall quality of the property: fair, average and good. (Id. 18-18-22; 19:1-10.) Ms. Ivers rated the Kmart property as fair based on the presentation of the building and the lack of any significant remodeling over the life of the building, which assigned a rental rate of \$6.25 per square foot. (Id. 19:1-14.) Properties rated good are valued using a rental rate of \$12.50 per square foot and properties rated average are valued using a rental rate of \$9.25 per square foot. (Id. 22:12; 28:6.)

16. Ms. Ivers testified that she determined the value of the Kmart property for the DOR. (Id. at 15:11-12.) She used the DOR's model income approach to determine its market value using the fair rental rating and the same expense and capitalization rates DOR uses to determine the market value of all commercial properties located across the state. (Id. at 33:6-20.) Ms. Ivers calculated the Kmart property's gross market rent by multiplying the building's square footage by the rental rate ($\$6.25 \times 84,000 \text{ sq. ft} = \$525,000$) and reduced that by 18.1% for vacancy and collections and an additional reduction of 15.9% for all other operating expenses to calculate the property's net market operating income as \$361,610. (MDOR Ex. A.) Applying the DOR's capitalization rate of 8.6% to the net operating income ($\$361,610 \div 0.086$) calculates a market value of \$4,204,770. (Id.)

BEFORE THE MONTANA TAX APPEAL BOARD
Voegle's Inc. v. DOR

17. In response to a question from Mr. Voegle asking why the DOR does not use actual rent and expense figures to value properties, Ms. Ivers responded: "State law is very specific as to the appraisal methodology that we are required to use. In order to value everyone on a fair and equitable scale, we're going to use the market rents that's provided to us by essentially the market from the people in the industry." (MTAB Hrg. Transcr. 23:15-19.)
18. Ms. Ivers testified that the Staples box store, which is located within a few hundred yards of the Kmart property sold in 2007 for \$5,175,000 and the DOR's income model calculated a value of \$5,188,00, using a good rent rating at \$12.50 per square foot. (Id 20:13-23; MDOR Ex. F.) Ms. Ivers also testified that the ShopKo building, located in the same complex as the Kmart property, sold for a little over \$9,200,000 in 2015 and the DOR 's income model calculated a value of a little over \$8,900,000, again using the good rental rate of \$12.50 per square foot. (Id. 21:13-24; 22:5-13; MDOR Ex. G.)
19. Jason Boggess, the DOR Regional Manage for Region II which includes Cascade County, testified that in order to determine market value the DOR values all properties as if they are "fee simple where we value properties unencumbered from all leases." (Id. 38:4-8.) Mr. Boggess explained that to determine any commercial property's market value the DOR values the land and buildings without considering the business attached to it. (Id. 39:12-13.)
20. The DOR develops its market rental rates using actual rental income information submitted annually to the DOR by commercial property

BEFORE THE MONTANA TAX APPEAL BOARD
Voegle's Inc. v. DOR

owners throughout the state. (Id. 42:9-14.) The DOR uses standardized market rents, and not the actual rent paid to each landowner, to calculate the market value for each reappraisal cycle, recognizing that not every property owner throughout the state is going to actually receive market rent. (Id. 47:3-6.) According to Mr. Boggess this is how the DOR equalizes market values for tax types throughout the state regardless of any individual property's actual rental rate. (Id. 46:15-19.)

CONCLUSIONS OF LAW

21. The Board has jurisdiction over this case and its order is final and binding upon all parties unless changed by judicial review. Mont. Code Ann. § 15-2-301.
22. To whatever extent the foregoing findings of fact may be construed as conclusions of law, they are incorporated accordingly.

Burden of Proof

23. The taxpayer bears the burden of proving the error of DOR's value. *Farmers Union Cent. Exch., Inc. v. Dep't of Revenue of State of Mont.*, 272 Mont. 471, 476, 901 P.2d 561, 564 (1995); *Western Air Lines, Inc. v. Michunovich*, 149 Mont. 347, 353, 428 P.2d 3, 7 (1967).
24. However, DOR cannot rely entirely on the presumption in its favor and must present a modicum of evidence showing the propriety of their action. *Western Air Lines*, 149 Mont. at 353, 428 P.2d at 7.

BEFORE THE MONTANA TAX APPEAL BOARD
Voegelé's Inc. v. DOR

Assessment

25. "All taxable property must be appraised at 100% of its market value...."
Mont. Code Ann. § 15-8-111.
26. "[T]he Legislature intended the Department to utilize both the cost approach and the market data approach, depending upon the available market data, when it assesses property and estimates market value."
Albright v. State By & Through State, 281 Mont. 196, 208, 933 P.2d 815, 823 (1997).
27. The Legislature has directed that the DOR use "a general and uniform method for purposes of appraising real property." Mont. Code Ann. § 15-7-103.
28. "For the taxable years from January 1, 2015, through December 31, 2016, all Class Four property (commercial buildings) must be appraised at its market value as of January 1, 2014." Mont. Admin. R. 42.18.124(1)(d).
29. "The method of appraisal and assessment provided for in 15-7-111 must be used in each county of the state so that comparable properties with similar full market values and subject to taxation in Montana have substantially equal taxable values in the tax year. . . ." Mont. Code Ann. § 15-7-112.

Administrative Rules

30. "[A]dministrative regulations interpreting the statute made by agencies charged with the execution of the statute are entitled to

BEFORE THE MONTANA TAX APPEAL BOARD
Voegelé's Inc. v. DOR

respectful consideration.” *Dep't of Revenue v. Puget Sound Power & Light Co.*, 179 Mont. 255, 266, 587 P.2d 1282, 1288 (1978).

31. The Board “may not amend or repeal any administrative rule of the department,” but may enjoin its application if the Board concludes the rule is “arbitrary, capricious, or otherwise unlawful.” Mont. Code Ann. § 15-2-301.
32. “‘Income Approach’ means the value of a taxpayer’s building(s) is/are developed by using income and expense information obtained from commercial buildings across the state.” Mont. Admin. R. 42.20.106(12).
33. “‘Mass Appraisal’ is the process of valuing a group of properties as of a given date, using standardized methods, employing common data, and allowing for statistical data.” Mont. Admin. R. 42.20.106(13).
34. “When determining the market value of commercial properties, department appraisers will consider, if the necessary information is available, an income approach to valuation.” Mont. Admin. R. 42.20.107(1).
35. “Market rent is the rent that is justified for the property based on an analysis of comparable rental properties, and upon past, present, and projected future rent of the subject property. It is not necessarily contract rent, which is the rent actually paid by the tenant.” Mont. Admin. R. 42.20.108(2).

BEFORE THE MONTANA TAX APPEAL BOARD
Voegelé's Inc. v. DOR

Prior Cases

36. In 1988, Northwest Land & Development of Montana, Inc., appealed the DOR's assessed value of commercial real property it owned in Billings which included a building rented to Kmart on a long-term lease since its construction in 1969 for an annual rent of \$187,200 plus a percentage of gross sales over \$7,560,000. *Northwest Land & Development of Montana, Inc. v. Dep't. Of Revenue* 1989 WL 96154 (Mont. Tax. App. Bd.). In that case, the taxpayer's attorney argued that the long term lease was a special circumstance that the DOR did not consider in its appraisal, where the taxpayer was responsible for payment of property taxes with no provision in the lease for increased rent if property taxes increase. *Id.* at 2.
37. In the *Northwest* appeal, the DOR cited this Board to the 13th Judicial District Court's 1983 decision regarding the same taxpayer's appeal in the prior cycle where in Judge Bartz stated:

Where the actual income for a long term lease does not reflect the true value of the property because the lease was made in a time of boom or depression or as a result of poor management, the Board may reject or give little weight to the capitalization of actual net income method. It has long been held that the existence of a lease at a low rental for a long term, not representing the fair rental value of the property, is not to be used for a basis for calculating actual values. Consequently, the true value of the property for assessment purposes is to be ascertained as if unencumbered by such a lease. . . . *Plaintiff should be cognizant of the fact that the tax in question is on the value of the property, not the value of the owner's interest in the property.*

BEFORE THE MONTANA TAX APPEAL BOARD
Voegele's Inc. v. DOR

Northwest Land and Development of Montana, Inc. v. State Tax Appeal Board, et al., DV-81-1389 (District Court for the 13th Judicial District) at page 4 (emphasis added).

38. This Board reached a similar conclusion in ten separate appeals where the landowners all owned improvements encumbered by long-term leases with the United States Postal Service upon terms that may have reflected market rent at the inception of the leases but with no guarantee that the rent remain at market rent over the remaining term and renewal periods.¹ In each case, this Board found that the contract rent was a benefit that clearly enured to the United States Postal Service and not to the landowners. However, in every case this Board rejected the appellants' income approach to value that was dependent upon the contract rent for each subject property as not being probative of the value of each property. Instead, this Board concluded that the market value of each subject property, for ad valorem tax purposes, must be determined as if it were unencumbered by a long term lease because the contract rent was not the actual market rent for the subject properties according to the date of valuation.
39. This Board reached the same conclusion in *Glacier Park, Inc. v. v. Dep't of Revenue*, 1995 WL 251438, giving the following reasoning:

The value which is presented here, by the taxpayer using the income approach, is the present value of the anticipated future benefits from its investment in northwestern Montana (including

¹ *Bickwell v. Dep't of Revenue*, 1988 WL 159299; *Hastetter v. Dep't of Revenue*, 1988 WL 159300; *Lambeth v. Dep't of Revenue*, 1988 WL 159295; *Howard v. Dep't of Revenue*, 1988 WL 159293; *Don Trippe Trucking v. Dep't of Revenue*, 1988 WL 159294; *Douglass v. Dep't of Revenue*, 1988 WL 159296-298; *Fusano v. Dep't of Revenue*, 1989 WL 163926; *Diehl v. Dep't of Revenue*, 1988 WL 163928; *Billmeyer v. Dep't of Revenue*, 1988 WL 163927.

BEFORE THE MONTANA TAX APPEAL BOARD
Voegle's Inc. v. DOR

the proceeds from its sale). The value of property for ad valorem tax purposes, using the income approach, is ordinarily not obtained by capitalizing the income of the subject property itself. Tax appraisers look to published studies, they mail out questionnaires to knowledgeable individuals and interview buyers and sellers of income properties to get enough reliable information to make a judgment of market value with some degree of confidence. ... Since ad valorem appraisals in Montana are required by statute to be of market value, the calculation of the most likely sales price of a property is as much art as science. Experienced appraisers test their value judgments by any one method against the results of another approach.

40. In the present appeal, concerning the Kmart property, DOR witnesses testified credibly that they consistently use the income approach as the best and most consistent method of valuation and equalization for commercial properties across Montana. The DOR witnesses testified that they have used the income approach of valuation for all similar "box store" properties in this appraisal cycle.
41. DOR's witnesses testified credibly that to equalize value as required by law, the DOR collects actual rent and expense data which it uses to generate a model for determining an income approach to reach market value. The DOR witnesses explained that they are precluded from using Taxpayer's actual income information to determine a market value for the Kmart property because that would reflect the value of the property to the business owner and not the true market value.
42. While Mr. Voegle is likely correct that Voegle's Inc. could not sell the Kmart property for \$4.2 million while the lease is in existence, he acknowledged that there is additional value to the property that is accruing to Kmart, the lessee, and not to the property owner. It is this

BEFORE THE MONTANA TAX APPEAL BOARD
Voegelé's Inc. v. DOR

additional value that the DOR has captured by using market rents to determine market value as opposed to using actual rents to determine the value of the property to the lessor.

43. However, Ms. Ivers was able to introduce property record cards for similar commercial properties in very close proximity to the Kmart property, and testified to her personal knowledge of their sale dates and price. This testimony corroborated that the values determined by the DOR's market model using the high rental rate closely correlated to the property's actual sales prices. This corroboration, while not in and of itself proof that the DOR has correctly determined the valuation of the Kmart property, gives this Board confidence that the DOR's income model determination of market value aligns closely with actual sales prices.
44. The DOR's witnesses presented a good explanation for why they used market rents in their income model to determine the market value of the Kmart property and not the actual rent. Based on the historical and uniform decisions of this Board to uphold DOR's methodology in the past, this Board concludes that the DOR has satisfied its burden to support its valuation of the Kmart property and the taxpayer did not present sufficient information to show that the DOR's valuation is erroneous.

BEFORE THE MONTANA TAX APPEAL BOARD

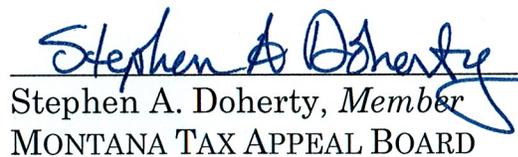
Voegele's Inc. v. DOR

ORDER

45. Voegele's, Inc.'s appeal and complaint is denied.
46. It is therefore **Ordered** that the subject property value shall be entered on the tax rolls of Cascade County for the tax years 2015 and 2016, at a total value of \$4,204,800; \$2,081,578 for the land and \$2,123,222 for the improvements.

Ordered June 27th, 2016.


David L. McAlpin, *Chairman*
MONTANA TAX APPEAL BOARD


Stephen A. Doherty, *Member*
MONTANA TAX APPEAL BOARD


Valerie A. Balukas, *Member*
MONTANA TAX APPEAL BOARD

Notice: You may be entitled to judicial review of this Order by filing a petition in district court within 60 days of the service of this Order. Mont. Code Ann. § 15-2-303(2).

BEFORE THE MONTANA TAX APPEAL BOARD
Voegele's Inc. v. DOR

Certificate of Service

I certify that I caused a true and correct copy of the foregoing Findings of Fact, Conclusions of Law, Order, and Opportunity for Judicial Review to be sent by United States Mail via Print and Mail Services Bureau of the State of Montana on June 27th 2016 to:

Voegele's Inc.

James A. Voegele
P.O. Box 1122
Great Falls, MT 59404

Merlin J. Voegele

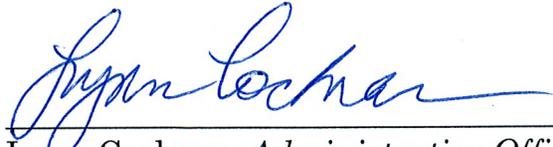
935 Vallejo Road
Helena, MT 59602

Michele R. Crepeau

Department of Revenue
Legal Services Office
P.O. Box 7701
Helena, MT 59604-7701

Bruce Kaye

Kmart Holding Corporation
3333 Beverly Road, BC-183A
Hoffman Estates, IL 60179



Lynn Cochran, *Administrative Officer*
MONTANA TAX APPEAL BOARD