

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

MICHAEL H. and SHELLEY PERETTI,)	DOCKET NO.: PT-2012-44
)	
Appellants,)	
)	FINDINGS OF FACT,
-vs-)	CONCLUSIONS OF LAW,
)	ORDER and OPPORTUNITY
THE DEPARTMENT OF REVENUE)	<u>FOR JUDICIAL REVIEW</u>
OF THE STATE OF MONTANA,)	
)	
Respondent.)	

Statement of Case

Michael H. and Shelley Lee Peretti (Taxpayers) appealed a decision of the Flathead County Tax Appeal Board (CTAB) relating to the DOR's valuation of their property located at 7185 U.S. Highway 93 South, in Lakeside, Montana. The Taxpayers argued the DOR overvalued the property for tax purposes, and seeks a reduction in value assigned by the DOR. At the State Tax Appeal Board (Board) hearing held on September 12, 2013, the Taxpayers were represented by Attorney Nathan Wagner. Appraiser James O. Kelley and Expert Edwin X. Berry provided testimony and evidence in support of the appeal. The DOR was represented by Amanda Myers, Tax Counsel. Scott Williams, Regional Manager, and Dan Lapan, DOR appraiser, presented testimony and evidence in opposition to the appeal.

The Board allowed the record to remain open for a period of time for the purpose of submission of post-hearing documents. Upon receipt of the

post-hearing submissions, and the Board having fully considered the testimony, exhibits, and all matters presented, we find and conclude the following:

Issue

The issue before this Board is whether the Department of Revenue determined an appropriate market value for the subject property for tax year 2012.

Summary

Based on a preponderance of the evidence, the Board affirms the decision of the Flathead County Tax Appeal Board.

Evidence Presented

1. Due, proper and sufficient notice was given of this matter and of the time and place of the hearing. All parties were afforded opportunity to present evidence, verbal and documentary.
2. Michael H. and Shelley L. Peretti are the Taxpayers in this proceeding and, therefore, have the burden of proof.
3. The subject property is a 0.461 acre residential lot with 159 feet of Flathead Lake frontage, with the following legal description:

Parcel 2, Tr. 2BD in L4, COS 18881, Section 07, Township 26N, Range 20W, 7185 Highway 93 South, City of Lakeside, County of Flathead, State of Montana, (Appeal Form, DOR Exh. B.)

4. For tax year 2012, the DOR originally appraised the subject property at a value of \$1,523,181: \$1,356,201 for the land and \$166,980 for the improvements. (Appeal Form, DOR Exh. B.)
5. The Taxpayers filed an appeal with the Flathead County Tax Appeal Board (CTAB) on May 29, 2012, stating:

“The appraised value as determined by the DOR did not take into account the significant deterioration of the market that had taken place from the peak of the

market through July 1, 2008, considered property which were statistical outliers, considered properties that were located in exclusively residential areas while the subject property is surrounded by commercial properties. The Taxpayers commissioned an appraisal of the property to be conducted by Kelley Appraisal which established a market value of the property at \$496,000 as of July 1, 2008. The DOR should adjust the value of the property to reflect this appraised value.” (Appeal Form.)

6. The Flathead CTAB heard the appeal on January 17, 2013, and reduced the land value to \$1,192,500 and the improvement value to \$125,000. The land value was reduced to \$7,500 per front foot for the subject 159 front feet of lake frontage, in keeping with the CTAB’s 2010 adjustment on this property. (Appeal Form Attachment.)
7. The Taxpayers appealed to this Board on January 23, 2013, stating:
“Appraised value is too high.” (Appeal Form.)
8. The Taxpayers requested a land value of \$900,000 and an improvement value of \$60,000 based upon a summary appraisal report that he commissioned. (Appeal Form.)
9. Taxpayers had also appealed the valuation on his property in 2010 when it was jointly owned with his sister. A subsequent division of the property into two parcels separated their ownership, so that the parcel now under appeal is jointly owned by Mr. Peretti and his wife, the Taxpayers in this case. The final valuation in the 2010 case, based on \$7,500 per front foot, is now on appeal to the District Court. The adjoining property, owned by Mr. Peretti’s sister, is not included in the instant case. (Testimony CTAB.)
10. At the hearing before this Board, Taxpayers presented a fee appraisal (Taxpayers’ Exhibit 5) done by James O. Kelley, a licensed appraiser. Mr. Kelley described the property as residential land in Lakeside, close to commercial establishments and condo developments. In his opinion, the proximity of commercial properties diminished the value of the land as

residential. His valuation is premised on his assumptions that no purchaser would keep the existing buildings and, further, that no purchaser would build a high-priced home so close to downtown Lakeside. His conclusion that the property was not comparable to other properties on Flathead Lake led him to base his estimate of valuation solely on the sales of a few lake-front properties also located in Lakeside.

11. Mr. Kelley used three Lakeside sales to value the Peretti property. The sales occurred in 2003, 2004 and 2006. In order to time-trend the sale prices to the value on the 2008 valuation date, Mr. Kelley selected several other properties that sold twice during the valuation period, relying most heavily on two non-lakefront properties. From these sales, he concluded that the price increases averaged 13.5%. His time-trend analysis used post-valuation date sales which, Mr. Kelley claimed, were necessary to show that values were dropping rapidly at the time of valuation. The lack of 2008 sales actually showing that decline, he explained, required him to look at post-valuation sales.
12. Relying heavily on the second of the three comparable sales used in his analysis, property that is only 400 feet from the subject property, Mr. Kelley concluded that the \$6,189 per-front-foot average of the three comparables he used should be lowered to the \$5,700 front-foot price of comparable two as it is closest and most similar to the subject property. (Testimony Kelley.) Mr. Kelley also relied on a recent survey of the property establishing the front footage as 169 feet rather than the 159 feet used in the DOR valuation. He thus concluded a value for the subject property of \$960,000 for the land and no value for the improvements. (Taxpayers' Exhibit 5, p.25.)

13. Mr. Edwin X. Berry was presented as an expert witness with math and physics credentials and experience in modeling land valuation computer software. He criticized the DOR's formulas in its computer assisted land pricing model. He stated that the DOR used a straight line regression instead of a multiple-factor regression and that the results were demonstrably weak in that the formula produced an R^2 of just 17.98% suggesting inaccurate value projections. He submitted a series of graphs (Taxpayers' Exh.8) showing how to refine the data by discarding high value outliers, removing the time-trended sales as causing problems and then removing all but the final year of sales, rather than the multiple years used by the DOR. He also included sales that occurred after the July 1, 2008 valuation date mandated by law. He concluded the true average price per front foot was \$7,473. (Taxpayers' Exh. 8, p. 4.)
14. Taxpayers did not submit any evidence of Mr. Berry's testimony to the DOR prior to the hearing, nor did they provide a *curriculum vitae* for Mr. Berry or any narrative explanation of his mathematical analysis. The DOR requested and was granted permission to submit a response to the Berry testimony after the hearing.
15. The post-hearing submission by Department of Revenue Region 1 manager Scott Williams contended that Mr. Berry had incorrectly assumed that the DOR used a single variable to create the linear regression whereas it is clear from the face of the materials that the DOR used three variables. Mr. Williams stated that the R^2 value of the DOR regression was 83.33%, a high value indicating a reliable formula. Without a narrative description of the process used, Mr. Williams was unable to determine why Mr. Berry discarded some of the comparable sales, as well as discarding the time trending, except that each refinement

steadily lowered the valuation in his client's favor. Mr. Williams also noted that even using Mr. Berry's suggested corrections in his time-trending, the resulting calculations showed an increase in average prices of 3.52% per month, or more than 40% increase per year in lakefront values during the early years of the six-year appraisal cycle, a rate of increase far higher than the 13.5% used in Mr. Kelley's appraisal.

16. In support of the DOR valuation, Mr. Dan Lapan, DOR appraiser, presented the DOR's computer assisted land program, which used 29 waterfront sales that have occurred in the neighborhood since the last appraisal, which showed a \$9,801 average front foot value for lakefront property. (DOR Exh. H.)
17. Mr. Lapan also submitted testimony of two further sales, selected for the properties' proximity to commercial enterprises and busy lake access which Mr. Peretti and Mr. Kelly had claimed made the subject property unique. The first sale occurred on June 30, 2008, one day before the valuation date and, therefore, highly indicative of the state of the market at the precise time property was to be valued. It showed a front-foot value of \$9,267. The second sale occurred in October of 2004 and showed a time-adjusted sale price of \$9,089 per front foot. Both properties are across the lake from the subject property and not, therefore, within the same neighborhood as the properties used to value the subject property but were presented to show that proximity to commercial properties did not reduce values and that lakefront values had not fallen as of the valuation date. (DOR Exh. F.)
18. Mr. Lapan also presented photos of Mr. Kelley's comparables and showed that the one most heavily relied upon is a steep, boulder-covered

property which he believes is not comparable in value to the essentially flat and easily built-upon subject property. (DOR Exh. G.)

Principles of Law

1. The State Tax Appeal Board has jurisdiction over this matter. (§15-2-301, MCA.)
2. All taxable property must be assessed at 100% of its market value except as otherwise provided. (§15-8-111, MCA.)
3. Market value is the value at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. (§15-8-111(2)(a), MCA.)
4. For the taxable years from January 1, 2009, through December 31, 2014, all class four properties must be appraised at its market value as of July 1, 2008. (ARM 42.18.124(b).)
5. Residential lots and tracts are valued through the use of CALP models. Homogeneous areas within each county are geographically defined as neighborhoods. The CALP models reflect July 1, 2008, land market values. (ARM 42.18.110(7).)
6. The state tax appeal board must give an administrative rule full effect unless the board finds a rule arbitrary, capricious, or otherwise unlawful. (§15-2-301(4), MCA.)

Findings of Fact and Conclusions of Law

The Board must determine, based on a preponderance of the evidence, whether the DOR set an appropriate value on the subject property for tax year 2012.

The Board has authority to hear evidence, find the facts, apply the law and arrive at a proper value for the subject property. As a general rule, the

appraisal of the Department of Revenue is presumed to be correct and the Taxpayers must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. *Farmers Union Cent. Exch. v. Department of Revenue*, 272 Mont. 471, 901 P.2d 561, 564 (1995); *Western Airlines, Inc. v. Michunovich*, 149 Mont. 347, 353, 428 P. 2d 3, 7, *cert. denied* 389 U.S. 952, 19 L. Ed. 2d 363, 88 S. Ct. 336 (1967.)

In this case, we find the DOR has provided the evidence that it used, as required by Montana law, and the comprehensive computer assisted land pricing data that includes 29 sales in the neighborhood, was more persuasive than the three comparable sales used by Mr. Kelley. Mr. Kelley's appraisal used limited data because of his assumptions about the limited desirability of the property due to its proximity to the Lakeside business strip. We note that no Taxpayers evidence was presented to show a negative effect on values, but the DOR presented evidence to the contrary showing sales of two properties with heavy use commercial neighbors that sold for prices comparable to the value asserted by the DOR. We find that the DOR evidence to be generally more persuasive than the Taxpayers' evidence as to value of the subject property.

Mr. Kelley also used post-valuation date sales to show a decline in values, a practice not permitted by Montana statutes. The DOR must value all property in Montana on the same date, using the data gathered as of that day, in order to achieve the statewide equalization required by law.

Mr. Kelley also made an assumption that the buildings would be razed by the purchaser and therefore included no value for them in his appraisal. The DOR valued the buildings on the property as they are certainly habitable and in current use. The DOR is not authorized to make subjective assumptions about

the plans of possible future buyers or choose not to value modest structures in an upscale neighborhood because they might be replaced by a new purchaser.

Mr. Kelley's appraisal also calculated a 13.5% annual increase in values basing his rate on just two non-waterfront properties that sold twice in the period while the DOR's rate of increase was based on a 29-sale sample of waterfront properties. The difference in the time-trending rates alone could account for the difference in valuations and there is no evidence to suggest that the Kelley calculations are more accurate than the DOR's.

Finally, we find Mr. Kelley's very limited sample and subjective assumptions about buyers' preferences renders his valuation less credible than the one presented by the DOR. His use of post-valuation date sales and sales of non-waterfront property also violate the regulations governing the valuation process.

We find that Mr. Berry's mathematical critique of the DOR's computer assisted land pricing model suffers from several failings. First, it appears Mr. Berry completely misunderstood the nature of the model and so his criticisms of it are not accurate. Furthermore, his apparent goal was to achieve greater predictive accuracy with a high R^2 factor and thus, he discarded sale and trending data points until he got the result he sought. The purpose of the model used by the DOR, however, is to find a statistical average of actual land sale prices, not create an elegant graph with carefully-selected, closely-grouped data points. Finally, he misinterpreted the R^2 factor of the DOR's model as 17.98% when it was, in fact, 83.33%, higher than the R^2 of 74.94% Mr. Berry achieved in his final graph with all of his refinements. We do not find the critique of the DOR valuation model credible.

We can find no reason to conclude that the Taxpayers are entitled to a lower valuation and we affirm the holding of the CTAB below.

Procedural Issues

The Taxpayers in this matter failed to disclose their expert report prior to the hearing, despite requests by the DOR. The Board thus allowed the DOR a response after the hearing date. The Taxpayers objected to the response.

The Taxpayers' objection to the post-hearing submission on the grounds of hearsay and unauthorized testimony are noted and denied. Taxpayers contend Mr. Williams should have been limited to legal and not factual matters but there are no such restrictions imposed by our order. The Taxpayers' failure to present the expert and his complex mathematical critique in advance for the DOR, as well as the lack of a narrative explanation of the methods used or the reasons for them, or even the inclusion of explanatory footnotes to the graphs submitted at the hearing, clearly justify the grant of an extension to allow the DOR sufficient time to respond to the testimony and exhibits.

Allowance for response time is especially appropriate in light of the fact that the DOR requested the material in advance, the Taxpayers declined to provide it, and that credible complaints about Taxpayers' discovery procedures were made at the hearing. Mr. Williams was sworn before his testimony and was still under oath until the hearing record closed. The Taxpayers' attorney, as required by his license, should have paid closer attention to routine pre-hearing practices, which would likely have avoided that result. It would also have permitted a more meaningful cross examination of Mr. Berry at the hearing. We note that Taxpayers were given the opportunity to respond to the post-hearing submission and did submit objections but did not specifically refute Mr. Williams' criticisms.

Order

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property value shall be entered on the tax rolls of Flathead County at a 2012 tax year value as determined by the Flathead County Tax Appeal Board.

Dated this 1st day of November, 2013.

BY ORDER OF THE
STATE TAX APPEAL BOARD

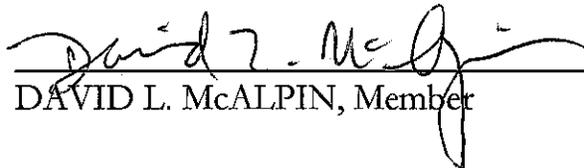


KAREN E. POWELL, Chairwoman

(SEAL)



SAMANTHA SANCHEZ, Member



DAVID L. McALPIN, Member

Notice: You are entitled to judicial review of this Order in accordance with Section 15- 2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 1st day of November, 2013, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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