

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF MONTANA,)	DOCKET NO: PT-1997-166
)	
Appellant,)	
)	
-vs-)	
)	
ALMANOR INVESTORS LIMITED)	FINDINGS OF FACT,
PARTNERSHIP,)	CONCLUSIONS OF LAW,
)	ORDER and OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>
Respondent.)	

The above-entitled appeal was heard on May 23, 2000, in the City of Helena, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was given as required by law.

Tax Counsel Brenda Gilmer represented the Department of Revenue (DOR). Appraiser Don Blatt presented testimony in support of the appeal. The taxpayer, represented by Don E. McBurney, Agent, Collins Management Company, presented testimony in opposition thereto. Testimony was presented, exhibits were received, and a schedule for post-hearing submissions was established. The Board took the appeal under advisement; and the Board having fully considered the testimony, exhibits, post-hearing submissions, and all things and matters presented to it by all parties, finds and concludes as follows:

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, the hearing, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.
2. The property which is subject of this appeal is described as follows:

Floweree Addition, Block 25, East 36 feet of Lots 10 and 11, Lots 1 - 13; Northern Pacific Addition, Block 35, Lots 9 and 10, City of Helena, Lewis & Clark County, State of Montana and improvements located thereon; geo code #1888-29-3-29-08-0000. (Assessor code #0000000091.)
3. For the 1997 tax year, the DOR appraised the subject property at \$192,510 for the land and \$1,491,900 for the improvements.
4. The taxpayer timely filed an AB-26 Property Adjustment Form with the DOR on October 1, 1997, requesting a formal meeting with the DOR to discuss the taxpayer's opinion of an over valuation of the property.
5. DOR appraiser Don Blatt denied an adjustment of the market value on February 12, 1998, stating:

After review, I felt appraisal was a fair market value.
6. The taxpayer appealed to the Lewis and Clark County Tax Appeal Board on March 10, 1998 requesting a value "To be determined" and stating no reasons for the appeal.
7. In its June 5, 1998 decision, the county board approved the

taxpayer's request for a reduction in appraised value, entering the amount of \$986,723 under the "Personal Property" section of the "Appraised Value as Determined by Taxpayer" section of the appeal form, rather than in the section entitled "Appraised Value set by County Board Decision," stating:

Department of Revenue offered no testimony on how the cost or income approach can be applied to subsidized housing.

8. The DOR appealed that decision to this Board on July 2, 1998, stating:

The nature of the proof adduced at the hearing was insufficient from a factual and a legal standpoint, to support the Board's decision.

9. The DOR's final determination of market value of \$1,684,410 was established from the cost approach to value.
10. The Board's decision has considered the evidence and testimony presented in PT-1997-164, DOR v. Joseph B. Reber & Sons Partnership and PT-1997-165, DOR v. Helena Partners Limited Partnership.

DOR'S CONTENTIONS

Department of Revenue's Exhibit A illustrates the location of the subject property. Exhibit B, the computer-generated property record card for the subject property, illustrates a land value of \$192,510 and a value of \$1,491,900 for the improvements, for a total value of \$1,684,410. Mr. Blatt testified, "the Department of Revenue and both fee appraisals agree on the square footage of 102,735 square

feet." The DOR valued the land as if vacant at \$1.87 a square foot, and the Computer Assisted Land Pricing (CALP) model for the subject neighborhood 211 was presented as DOR Exhibit N. The Department of Revenue's post-hearing submission indicated the zoning on each of the land sales in the CALP table, as well as the City of Helena's definitions of zoning designated as "R-2" (single-family residential), "R-3" (medium density residential) and "T" (transitional) and the requirements and permitted uses in these zones.

The subject improvements were valued on the cost approach method as apartment buildings. Mr. Blatt explained that a garage that was added to the property in 1998 was shown on the property record card, but its value is not included in the total value under appeal. Although the property record card indicates that the apartment complex contains 60 two-bedroom units, there actually are 24 two-bedroom units and 36 three-bedroom units as correctly indicated in Department of Revenue Exhibits G and H. Mr. Blatt testified that, following the filing of an AB-26 form for review of the property valuation (DOR's Exhibit C) by the manager of the subject property, he had performed a "full internal inspection" of the property on January 27, 1998. Based upon his review analysis, he "felt the appraisal was fair market value" and he had made no changes. DOR's Exhibit D is a copy of the appeal form filed with the Lewis and Clark County Tax Appeal Board on March 10, 1998.

DOR's Exhibit E is an undated copy of "*Procedure for Federally*

Subsidized Housing", summarized in pertinent part as follows:

Purpose: To explain the procedure for the valuation of federally subsidized housing

Procedure: Introduction:
According to 15-1-101(e) and 15-6-134(3), MCA, federally subsidized housing properties are similar and comparable to other apartment housing. However, you do need to take into consideration the benefits generated through the federal subsidies.

This procedure will also serve as a basis for appeals when necessary. All three approaches to value should be considered.

Ms. Gilmer testified that the procedure described in Exhibit E was taken from a DOR procedures manual compiled in 1993. Mr. Blatt stated that the procedure is "an attempt to address some of the concerns about any effects the subsidy may or may not have on the property, depending on what type of subsidy it is." He testified that he had spoken with the prior property manager, Dale Fasching, two years previously requesting HUD information on the subject property and other properties. Mr. Blatt indicated that he had attempted to do the necessary research as outlined in Exhibit E, but "didn't have much cooperation."

DOR's Exhibits G and H are copies of the fee appraisals required by HUD when a property is nearing the end of its HUD contract term. Exhibit G is a fee appraisal of the subject property prepared by William D. Diehl, Ph.D., IFAS, ASA, of Western Appraisal & Consulting, PC. Mr. Diehl's cover letter to Mr. Dennis Thacker of the HUD Contract Division, dated October 29, 1994, reads in pertinent part:

My assignment was to estimate the Extension Preservation value of the property known as the Al Manor Apartments Project at 1415 Missoula, Helena, Montana.

The purpose of this appraisal is to estimate the market value of the fee simple estate of the property as of August 9, 1994 subject to the assumptions and limiting conditions and certifications contained herein. The definition of value used in this report is defined on page 14...

Based on consideration of the factors affecting its value and analysis and data contained in the report, it is my opinion that the as is market value as of August 9, 1994 was: **\$1,454,000**.

DOR's Exhibit H is a copy of a fee appraisal of the subject property prepared by the firm of Kramer, Geisler, Strand & Dayton, Inc. The cover letter, prepared by Kenneth A. Dayton, MAI, dated October 10, 1994, reads in pertinent part:

Estimates of Almanor's extension and transfer preservation values have been completed for the above referenced real estate, per the appraisal guidelines of Title VI. The purpose of this appraisal is to meet the appraisal requirements for the owner's filing under the Low Income Housing Preservation and Residential Homeownership Act (LIHPRHA) of 1990. An extension preservation value is the "as is" market value of the subject real estate that assumes it is to be converted to market rate (non-subsidized) rental housing. The transfer preservation value is an "as is" value that assumes the subject real estate is converted to its highest and best use. Herein, I will show that the highest and best use of the subject real estate is as a market rate rental housing project. Therefore, in this case, the extension preservation value equals the transfer preservation value.

In arriving at a preservation value, Title VI appraisal guidelines condition the market value in that the valuation is to reflect HUD's estimate of required repairs and their estimated cost for such repairs.

The Title VI appraisal guidelines encourage appraisers to use in their valuation a 7% vacancy and credit loss allowance and to also limit expenses to either the average of the subject's past three years or the last 12 months, whichever is more representative of the subject property. However, the guidelines indicate that a divergence from these regulations can occur, as done herein, if the divergence is supported with appropriate market evidence.

Presented below is my estimate of the subject's extension preservation value with the effective date of opinion being 8/25/94:

\$2,184,105, composed of: land value - \$150,000; improvement value - \$2,034,105.

Summarized, the following table illustrates information from the two independent fee appraisals along with the DOR's appraisal:

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Appraiser	DOR (various exhibits)	Western Appraisal (exhibit G)		Dayton (exhibit H)	
Date of Value	1/1/96	8/ 9/94		8/25/94	
Property Rights Appraised		Fee simple		Fee simple	
Function of the Appraisal	Ad Valorem Tax	Preservation program		Preservation program	
Land Value	\$192,510	\$194,000		\$150,000	
Market Value – Cost Approach	\$1,684,410	\$1,668,000		\$2,300,000	
Market Value – Income Approach	\$2,891,100	Income approach Stabilized market	\$1,691,000 \$1,680,000	Income approach	\$2,230,000
Market Value – Sales Comparison Approach	\$2,602,020	Price per room Price per unit Price per square foot Gross income multiplier Conclusion: Sales Comparison	\$1,839,840 \$1,691,520 \$1,750,505 \$1,912,248 \$1,692,000	Price per unit Price per room Gross income multiplier Conclusion: Sales Comparison	\$2,220,000 \$2,208,000 \$2,550,600 \$2,220,000
Extension Preservation Value	NA	Market value Less cost of conversion Equals extension preservation market value Rounded	\$1,680,000 <u>\$ 226,309</u> \$1,453,691 \$1,454,000	Market Value Less cost of conversion Equals extension preservation market value	\$2,230,000 <u>\$ 45,895</u> \$2,184,105
Final Value Estimate	Cost approach \$1,684,410	Extension preservation value	\$1,454,000	Extension preservation value	\$2,184,105
Unit Mix	24 two bedroom units 36 three bedroom units 1 retail building	24 two bedroom units 36 three bedroom units 1 office/laundry facility 1 maintenance garage		24 two bedroom units 36 three bedroom units 1 office/laundry facility 1 maintenance garage	
Monthly Rents	Two bedroom units - \$410 per month Three bedroom units - \$555 per month	Two bedroom units - \$400 per month Three bedroom units - \$425 per month		Two bedroom units - \$480 per month Three bedroom units - \$565 per month	
Income Approach	Exhibit K	Pages 56-59 & 61-64		Pages 67-89	
Potential gross income	\$361,483	Unknown (1)		\$382,320	
Vacancy/collection loss	\$ 32, 315 (9.4%)	2%		\$13,464 (6%)	
Effective gross income	\$329,168	Unknown (1)		\$368,856	
Expenses	\$ 66,078 (20%)	Unknown (1)		\$151,059 (41%)	
Net operating income	\$263,090	\$145,595		\$217,797	
Overall capitalization rate	9.1%	8.61%		9.75%	
Value indication (rounded)	\$2,891,100	\$1,691,000		\$2,230,000	

(1) Page 60 of the Western appraisal (exhibit G) has been omitted from the exhibit. The actual data for the portions of the income approach are unknown.

DOR's Exhibit I depicts results of a formula used by the DOR to derive the square footage costs for each of the five buildings in the

Almanor complex (*formula: undepreciated value = depreciated value divided by .74 divided by square footage*). Mr. Blatt explained that .74 was used in the formula because 26% depreciation has been applied to the subject property; therefore, it is considered to be 74% good (Exhibit B). Using the formula and applying a 105% economic condition factor (ECF) and a 97% Lewis and Clark County adjustment results in an adjusted total value of \$2,116,142 or **\$40.56** per square foot. No adjustments were made for economic obsolescence. Mr. Blatt testified that the DOR's purpose in developing Exhibit I was to provide a means of comparing its square footage price with the square footage prices in the two fee appraisals (Exhibits G and H). He pointed out that, on page 96 of the Dayton appraisal (Exhibit H), the price per square foot is shown as **\$60.78**.

Mr. Blatt testified that he had determined the quality of construction grade for the subject property to be *average minus*, the physical condition to be *good*, and the functional utility to be *good*. In support of his grade for functional utility, Mr. Blatt stated, "these apartments meet a niche in the market. Essentially there's demand for these types of property... *I could not find and document a reason to decrease the functional utility or add an amount that would deduct for functional utility.*"

DOR's Exhibit J, entitled "*Apartment Analysis*," is a compilation of 49 income and expense surveys returned to the DOR by individual

property owners with income properties located in various Helena neighborhoods, including neighborhood 211 (in which the subject property is located), but excluding neighborhood 215 (the original Helena townsite). Of the 49 surveys, seven of the properties were involved in a sales transaction. Based on the sales illustrated on Exhibit J, a total capitalization rate of 9.1% was determined for apartment property in neighborhood 211. This is shown in Exhibit K.

Mr. Blatt testified that he did not know how many of the 49 properties were in the same government subsidy program as the subject property. He explained that the department uses these questionnaires when developing an income approach model and he testified, "*Exhibit J was specifically used to come up with the income approach for multiple neighborhoods in Helena. An income approach was developed for this property but not used.*" His research suggests a price per unit of **\$43,367**. If applied to the 60 units in the subject property, the result is a value of **\$2,602,020**.

DOR's Exhibit K is an eight-page document showing computer screen print-outs of the information used in developing an income model for the subject property, based on the information that had been compiled in Exhibit J. Exhibit K, which shows a 9% vacancy factor, a 20% expense factor, and a capitalization rate of 9.1%, suggests a market value of \$2,891,000. Mr. Blatt testified, "when I've reviewed not only this property but other properties, there were a lot of anomalies that needed research on this. I clearly felt that the cost approach was the

best indicator of value, and that's the value I actually used as my final determination of value." He further commented, "If you look at (exhibit) K, ... there's an indication here of a cost approach, \$1,692,000, and income approach, \$2,891,000, a 71% ratio. That may or may not be correct. To me that means research. I had confidence in the cost value and felt it was a fair indication of fair market value, and used the cost approach... Traditionally, all the counties that I've worked in have relied strongly on the cost approach... Lewis and Clark County did not mail out an income value as the fair market value as assessed by us until 1997 with the '96 reappraisal. It's a manpower issue, mainly. It takes time to research the data to the extent that you need to. At this time I was the only commercial appraiser in Lewis and Clark County, and still today there's only one commercial appraiser in Lewis and Clark County. The man-hours involved to thoroughly research these is not part of the work plan."

DOR's Exhibit L, a graph showing the values of the subject property according to the different approaches in the three appraisals, is summarized as follows:

APPRAISER	DOR (VARIOUS EXHIBITS)	DAYTON (EXHIBIT H)	DIEHL (EXHIBIT G)
INCOME VALUE	\$2,891,100	\$2,230,000	\$1,691,000
MARKET	\$2,602,020	\$2,220,000	\$1,692,000
COST	\$1,684,410	\$2,300,000	\$1,668,000
FINAL VALUE	\$1,684,410	\$2,230,000	\$1,680,000

The 1997 assessed value of the personal property for the Almanor complex was \$21,119, according to DOR's Exhibit M.

TAXPAYER'S CONTENTIONS

Mr. McBurney testified that, when Almanor's owners replaced their previous management company with Collins Management, "*hard feelings and jealousy*" resulted in records not being transferred, so he had little information on the property and the value as approved by the county tax appeal board; and he had hoped that his questions would be answered at today's hearing. Mr. McBurney requested no specific value and presented no exhibits.

Mr. McBurney opened his presentation by explaining the history of various Department of Housing and Urban Development (HUD) subsidized housing programs. The 235 program for single-family units was started after World War II to help veterans obtain housing, and was later expanded to low-income people. Its "sister program," 236, was developed to provide multi-family housing. In the late 1960's and early 1970's, the 221-d-3 and 221-d-4 programs were active, and many multi-family complexes were constructed before those programs were phased out. The subject property was constructed as a 236 project in 1969.

Mr. McBurney explained that the purpose of these HUD programs was to provide low-income housing, not to provide profit to developers. However, several incentives were available to encourage participation in the programs, including depreciation, mortgage rates and terms, and construction itself. The IRS codes provide for an allowance for depreciation, which reduces taxable income. Although "*a profit from*

income-producing properties is generally desirable, passive losses from unprofitable properties at that point in time could be used to help reduce overall profits and tax liabilities. Those losses could also accrue and be carried forward into future years." Mr. McBurney explained the mortgage incentive by stating, "*HUD guarantees financing through FHA insurance and buys the rate for these program properties down to one percent. However, that's a benefit to the tenants and not to the owners, because the actual mortgage is at market rates at the time of construction of the property. So, typically we find mortgages of seven to eight percent. The term of the mortgage is 40 years, very long term...which can be viewed as positive because the mortgage term is so long that monthly payments are low, but negative because pre-payment, or opting out of the program...during the first 20 years of the mortgage is not allowed. By the time the mortgage is fully matured, remaining economic life of the improvements is likely to be minimal. The original philosophy was that existing projects would go off line after that initial 20-year period as owners opted out of the government programs, but that the housing inventory would be replaced by new projects coming on line because of continuing ongoing program incentives."*

Often the original program participants would form construction companies to act as the general contractor during the building of apartment complexes. After a sufficient number of complexes had been

built, they would liquidate the construction companies and form management companies to manage the complexes, thus guaranteeing management income during the ensuing years. *"People could act as a general partner and syndicate by finding limited partners who would supply equity cash to the projects, and then sell the projects and their program benefits after 12 or 16 years. The bulk of the depreciation allowance would have been captured after that time frame, the sale agreement would reserve management rights to the seller, and expectation would be held out to the buyer that he could opt out from under HUD control in four to eight years, in other words, at the end of that 20-year time limitation; and then he could potentially convert the project to a market-based apartment complex."* However, this changed in 1986 with changes to the federal tax laws, including eradication of depreciation, lengthening of economic life tables, decrease in the annual depreciation allowances and elimination of passive losses *"to anyone not actively engaged in building and/or management programs."*

In 1987, Congress also enacted significant legislation, called Title II, imposing a moratorium on projects being able to opt out of HUD programs after the initial 20-year time period. The moratorium was in effect for five years, until it was lifted in 1992 by legislation known as Title VI and referred to as the Preservation Program. Mr. McBurney explained that the Preservation Program was the reason for

the existence of the two fee appraisals on the subject property (DOR Exhibits G and H). The legislation required that the owner of a property would hire an independent fee appraiser to come up with a report and final value conclusion, and HUD would also hire a fee appraiser to go through the same exercise. "So you had two reports. If the final value conclusions agreed with each other within five percent, there was no third appraiser. On the other hand, if the two value conclusions varied more than five percent, one of two things had to occur. Either the two appraisers would talk to each other and through some sort of mutual adjustment...they would amend their values so that they would then be within plus or minus five percent of each other; or a third appraiser would be hired. If a third appraiser were hired, he would be provided with the first two appraisal reports. He would do his own research, and he would also have full access to the first two reports. His report would be a final binding authority. These reports were to come up with a preservation value estimate, and that was anticipated to be...relatively speaking, a high number. That number would be compared with a, relatively speaking, low number that would be either a book value that was carried for the project, or a value estimate that came into being via actual profit and loss statements. The difference between the high and the low number would be a sum of money, then, that would be paid to the property owner as an incentive for him to preserve the project in the government

program, hence the name 'preservation'."

Mr. McBurney explained that the appraisers were required to follow the HUD guidelines and directives, which included "*that the appraiser treat the subject property as if it were not encumbered by this government program, as if it were entirely a market-based apartment complex.*" Although Mr. McBurney stated that the directive he described was not included in either of the fee appraisals on the subject property, he was "*confident that these appraisers had to comply with these requirements. Because of that, these appraisals are not applicable to the problem before us... because the mandate was in existence to treat the project as if it were unencumbered, as if there were no requirements to limit clientele to low income, as if it were entirely market based and could do whatever it wanted to. That was not, in reality, the case.*" Mr. McBurney believes that the subject property should be valued as encumbered because of the restrictions that are imposed upon it.

Mr. McBurney explained that Almanor is a limited dividend project. In these projects, the original developer or contractor could build the project for ten percent of total projected costs but was limited in the annual dividend he could collect to six percent of the original equity investment. "*In other words, if a project was projected to cost \$1,000,000...you could do that for ten percent, or \$100,000 equity infusion. Then the most that you could pull out of*

that project in any one year was \$6,000, six percent of the original equity investment." Mr. McBurney believes that the Department of Revenue could have determined a replacement cost new (RCN) for the subject property. Using their figures, "I did the arithmetic and got \$2,191,280. Now that cost is grossly in error, because it's much more current than 1969, when construction actually did take place." Using this number for purposes of illustration, Mr. McBurney stated that if that was the original construction cost, the developer could have constructed the project for ten percent of that, or \$219,128 "cash out of his pocket. He then would be limited in the cash that he could pull out of that to six percent, or \$13,148. In appraiser's terminology, we would call that NOI, net operating income".

Mr. McBurney testified that although the Department of Revenue Exhibits J and K indicated expense ratios of 25%, "in reality the expense ratios that we find in these program properties nearly always exceed 60%, because the incomes were so low and the government requirements for expense outlays were so high that the expense ratio is very high. The actual money that was pulled out of the subject property in 1995 was \$2,682...in 1996, \$2,682; in 1997 it was zero. Since the maximum amount allowed to be withdrawn could accrue and carry forward into future years, in 1998 there was a windfall, and they took out \$57,041... Over those four years, that's an average of \$15,601...which agrees fairly closely with the \$13,148 that we just

used in this other example... If we accept a low NOI, if we accept \$13,000 or \$15,000 and capitalize that, even at the Department of Revenue's 9.1%, we find the value indication on an order of magnitude of \$170,000, \$175,000 for the whole project, really a number that's so low that we would certainly be tempted to describe it as ludicrous."

In September 1998, Almanor opted out of the HUD program and became a market rent project, according to Mr. McBurney. He testified that he does not find fault with the department's presentation as it applies to September 1998 and forward. However, for the years under appeal, the department did not use comparable properties, in accordance with the definition found in Title 15, Section 1-101, MCA, which requires that *"comparable properties must be influenced by the same set of governmental factors."* The subject property was a HUD 236 property, and *"we don't know that any of the comparable properties were influenced by that same set of governmental factors. Very likely they were not."* Mr. McBurney testified that the Department of Revenue's overall capitalization rate of 9.1% is not accurate *"because it does not account for the additional risk" in a HUD property."*

Mr. McBurney concluded his presentation by stating that he was not asking for the value of \$175,000 that would be indicated by *"looking at traditional methodology and capitalizing NOI,"* but would be willing to accept the \$986,000 that was entered on the appeal form by the county tax appeal board as *"that number is much more reasonable*

as an indicator of market value for the subject property during the time that it was encumbered with this government program than the number that Department of Revenue is arguing for. I don't believe the Department of Revenue has made their case, because their exhibits are faulty, and I don't think it necessary for me to say anything else."

BOARD'S DISCUSSION

There have been three appraisals presented as evidence before the Board. The following table illustrates the date of value along with the various value conclusions:

Appraiser	DOR	Western	Dayton
Date of Value	1/1/96	8/9/94	8/25/94
Land Value	\$192,510	\$194,000	\$150,000
Market Value – Cost Approach	\$1,684,410	\$1,668,000	\$2,300,000
Market Value – Income Approach	\$2,891,100	\$1,691,000	\$2,230,000
Market Value – Sales Comparison Approach	\$2,602,020 (1)	\$1,692,000	\$2,220,000
Final Determination	\$1,684,410	\$1,454,000 (preservation value)	\$2,184,105 (preservation value)

DOR sales comparison was calculated at \$43,367 per rental unit. (60 X 43,367) (Exhibit J & Blatt testimony)

It is highly unlikely that different appraisers would arrive at the same value, especially when considering different market data and appraisal dates.

The DOR presented into evidence the two fee appraisals that offer support for their final value conclusion. The DOR must present credible evidence to show support for their value conclusion. The Lewis and Clark County Tax Appeal Board granted the taxpayer's appeal and the DOR appealed that decision to this Board. The DOR is the appellant in this appeal and carries the burden of proof. Steer Inc.

v. Department of Revenue, 245 Mont. 470, 1990.

The DOR has relied on the cost approach to value for the subject property. Albright v. Montana Department of Revenue, 281 Mont. 169, 1997 "For the valuation of commercial property, CAMAS produces a cost estimate and, in some instances, an income estimate. The income approach to valuation is the preferred method of valuation of commercial properties in Montana."(Emphasis supplied.)

Mr. Blatt testified that, in developing the income model, the DOR mailed property owners a survey requesting income and expense information. Based on the replies that were returned to the DOR, exhibit J was created, and that information was also used to create the income model (exhibit K) for the subject neighborhood.

Exhibit J contains income and expense data from forty-nine rental properties. Of the forty-nine properties, nineteen are duplexes, five are triplexes, and twenty-one are fourplexes.

ARM 42-20-104 COMPARABLE PROPERTY (3) Within the definition of comparable property in (1), the following types of property are considered comparable:

(b) Duplexes are comparable only to other duplexes; triplexes are comparable only to other triplexes; fourplexes are comparable only to other fourplexes. (Emphasis added.)

The Board's analysis of the DOR's income approach will exclude those properties that are not deemed comparable based on the DOR's own administrative rules.

The following table summarizes the information from the four rental properties, the two fee appraisals, and the subject property:

Data	Survey – Exhibit J	Subject – Exhibit K	Western – Exhibit G	Dayton – Exhibit H
# of rental units	NA	60	60	60
Monthly rent – 2 bedroom	\$240 - \$475 (average - \$358)	\$410	\$400	\$480
Monthly rent – 3 bedroom	\$500 - \$550 (average - \$525)	\$555	\$425	\$565
Vacancy/collection loss %	9% – 15%	9.4%	2%	6%
Management (% of Effective Gross Income – EGI)	None reported	None applied	Unknown	4.5%
Total expenses (% of EGI; includes management expense)	19% -59%	20%	Unknown	41%
Net Operating Income (NOI) (% of EGI)	81% - 39%	80%	Unknown	40.95%
Capitalization Rate	NA	9.1%	8.61%	9.75%

It is the Board's opinion that the DOR's income model has been developed recognizing property not deemed comparable pursuant to ARM 42-20-104 COMPARABLE PROPERTY. The CAMAS income model created to produce a market value indication is only as good as the information that has been used to create that model. It is the Board's opinion that the income model developed to estimate the market value for the subject property has not accurately accomplished that assignment.

Both the Western and Dayton appraisals have utilized the same definition of market value in their respective reports. This definition of market value does not differ dramatically from the definition used by the DOR, **§15-8-111 MCA**. Each appraiser has considered different market data, which would result in varying market value indications.

When valuing a property based on the cost approach to value, the personal property items normally associated with an apartment complex, i.e., refrigerator, stove, washers and dryers, are class eight property, pursuant to **MCA §15-6-138**. Class eight property is subject

to different depreciation tables and a different tax rate. While the personal property is not under appeal, the potential to collect rental income without these personal property items in place is highly unlikely. There is nothing in the record to suggest that the DOR adjusted the value indication from the income approach to reflect the presence of the personal property. The DOR's exhibit M, the 1997 tax statement, indicates that the market value of the personal property is \$21,119 for tax year 1997. The Board does not have sufficient evidence to rely on an appropriate adjustment to the market value from the income approach.

The Board questioned the DOR with respect to exhibit E, "Procedure For Federally Subsidized Housing", as to the applicability and relevance. An affidavit signed by Randy Wilke, Process Lead for the Compliance, Valuation and Resolution Section of the DOR, and submitted to the Board subsequent to the hearing and made part of the record, states the following:

I have personal knowledge that the attached procedure (Procedure No. 2201-Valuation of Federally Subsidized Housing) was developed and approved by the management of the Property Assessment Division in 1997.

This procedure was inadvertently not dated when it was approved but has been the procedure and practice of this agency since 1997.

MCA, §15-7-111. *Periodic revaluation of certain taxable property.(1) The department of revenue shall administer and supervise a program for the revaluation of all taxable property within classes three, four and ten. All other property must be revalued annually.*

The revaluation of class three, four, and ten property is complete on December 31, 1996. (Emphasis added.) Pursuant to Montana Code Annotated (MCA), the appraisal for the subject was completed prior to the policy being implemented. When asked if the procedure for valuing subsidized housing was in place as of January 1, 1997, Mr. Blatt stated "It is my understanding they came about in response to and after the appraisal date." (PT-1997-164, DOR v. Joseph B. Reber & Sons Partnership). It is apparent to the Board that the DOR's policy was created to assist the DOR in appraising multifamily properties that are subject to a government program. There is no indication that the DOR considered this policy in any way when appraising the subject property. There is nothing in the record to indicate that these questionnaires completed and returned by commercial property owners were involved with a HUD program. An income approach for a property located in Missoula County was included with the Wilke affidavit and varied significantly from the income approach for the subject:

Property	Subject (exhibit K)	Missoula (affidavit)
Income	\$357,840	\$332,064
Financing benefit	\$0	\$46,504
Retail / Laundry & vending income	\$3,643	\$4,787
Percent occupancy	91%	100%
Income after occupancy	\$329,168	\$383,355
Effective gross income	\$329,168	\$383,355
Total expenses	\$66,078	\$128,604
Management	\$0	\$26,835 (7% of EGI)
Total expenses	\$66,078	\$155,438
Net income	\$263,090	\$227,917

Property	Subject (exhibit K)	Missoula (affidavit)
Income Capitalization		

Equity ratio	.91	.09
Effective tax rate	0	.0215
Total capitalization	.91	.1115
Value, income approach	\$263,090/.91 = \$2,891,100	\$227,917/.1115 = \$2,044,100

As noted above, exhibit K does not take into consideration a management expense. IAAO (International Association of Assessing Officers), page 216, *"Management is a proper expense for every income producing property regardless of whether it is owner or tenant occupied and whether an actual management fee is paid or not. Management is usually stated as a percentage of effective gross income and varies depending on the geographic area and property type..."*

The Appraisal Standards Board (ASB) issued an Advisory Opinion, AO-14, *Appraisals For Subsidized Housing*, that was approved for general distribution on July 19, 1995. (Uniform Standards of Professional Appraisal Practice, USPAP, 1998) In pertinent part, AO-14 states the following:

...Subsidized housing may be defined as single- or multi-family residential real estate targeted for ownership or occupancy by low- or moderate-income households as a result of public programs and other financial tools that assist or subsidize the developer, purchaser or tenant in exchange for restrictions on use and occupancy...

...An appraiser should be capable of analyzing the impact of the programs and definitions in the local subsidized housing submarket, as well as the general market that is unaffected by subsidized housing programs...

...Subsidies and incentives should be explained in the appraisal report and their impact on value, if any, needs to be reported in conformity with the Comment section of Standards Rule 1-2(e), which states, **"Separate valuation of such items is required when they are significant to the overall value."**

Appraisers should be aware that appraisal of subsidized housing usually requires more than one value analysis predicated on different scenarios. In appraisal of subsidized housing, value conclusions that include the intangibles arising from programs will also have to be analyzed under a scenario without the intangibles in order to measure their influence on value and report the results without misleading the intended user.

The Dayton appraisal states in summary on page 46 under the "History" section, "...This project currently operates under Section 236 of the National Housing Act, with a separate contract held with HUD for 60 Section 8 leases..."

Both fee appraisers stated in their respective reports that the subject property is subject to a HUD subsidized program. There is nothing in the record to suggest that opinion AO-14 was considered. Nor was it suggested that this opinion was part of the appraisers' assignment.

The Dayton appraisal, exhibit H, states in pertinent part from the letter of transmittal:

"...Estimates of Almanor's extension and transfer preservation values have been completed for the above referenced real estate, per the appraisal guidelines of Title VI. The purpose of this appraisal is to meet the appraisal requirements for the owner's filing under the Low Income Housing Preservation and Residential Homeownership Act (LIHPRHA) of 1990. An extension preservation value is the "as is" market value of the subject real estate that assumes it is to be converted to market rate (non-subsidized) rental housing. The transfer preservation value is an "as is" value that assumes the subject real estate is converted to its highest and best use. Herein. I will show that the highest and best use of the subject real estate is as a market rate rental housing project. Therefore, in this case, the extension preservation value equals the transfer preservation value.

In arriving at a preservation value, Title VI appraisal guidelines condition the market value in that the valuation is to reflect HUD's estimate of required repairs and their estimated cost for such repairs."

Although the Western appraisal did not contain the same language in the letter of transmittal, the assignment of the appraiser was the same.

Mr. McBurney testified that two appraisals are ordered and if the value indications are not within 5% of each other a third appraisal is

requested. The extension preservation values for the respective appraisals are:

APPRAISER	MARKET VALUE
Western	\$1,454,000
Dayton	\$2,184,105

The appraised values are clearly outside the testified range of 5%. The Board was not provided any evidence or testimony concerning a third appraisal report.

Mr. McBurney testified that the subject property was removed from the HUD controlled program and converted to a market-based housing project. He testified that as a "market project" the DOR's value is a fair representation of the actual market value.

The local board's market value determination was established from taxpayers' exhibit #1 from the county board hearing. Summarized, this exhibit illustrates the following:

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Audited Financial Statements
 Twelve Months Ended
 December 31, 1995

Income		
Rents		\$ 262,944
Laundry & Vending		8,687
		271,631
Less Vacancy		(2,725)
Total		268,906
Operating Expenses		
Administrative	\$43,607	
Utilities	42,394	
Operating & Maintenance	49,610	
Taxes & Insurance	29,689	
Total		165,300
Net Operating Income		\$ 103,606
=====		
Value:		
CAP rate	10.5%	\$ 986,723
CAP rate	12%	\$ 863,383

Property	Subject	Sale #1	Sale #2	Sale #3	S
Location	Helena	Missoula	Billings	Billings	B:
Sale Date	NA	4/29/94	7/15/94	8/11/94	9
Sale Price	NA	\$1,315,000	\$750,000	\$2,500,000	\$:
Number of Units	60	50	36	80	
Year Built	1969	1972	1977	1977	
Effective Gross Income	\$268,906	\$226,500	\$161,513	\$475,300	\$:
Operating Expenses	\$165,300	\$ 84,214	\$ 83,483	\$198,500	\$
Net Operating Income	\$103,606	\$140,036	\$ 78,030	\$276,800	\$
Gross Income Multiplier	NA	5.8	4.6	5.2	
Overall Rate (OAR)	NA	10.6%	10.4%	11.1%	
Expense Ratio (% of Effective Gross Income)	61%	37%	52%	42%	
Price Per Apartment	NA	\$26,300	\$20,833	\$31,250	\$

The taxpayer's sales are located outside of Helena, in larger cities. Sales from within Helena would offer the best indication of local market, but when comparable sales do not exist, the market area may need to be expanded.

42.20.107 Valuation Methods For Commercial Properties

(1) When determining the market value of commercial properties, other than industrial properties, department appraisers will consider, if necessary information is available, an income approach valuation. (emphasis added)

(2) If the department is not able to develop an income model with a valid capitalization rate based on stratified direct market analysis method, the band-of-investment method or collect sound income and expense data, the final value chosen for ad valorem tax purposes will be based on the cost approach or, if appropriate, the market approach to value. The final valuation is that which most accurately estimates market value. (emphasis added)

42.20.108 Income Approach

(2) The following procedures apply when valuing commercial property using the income approach:

(b) 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 a tenant.

(3) The department will use generally accepted procedures as outlined by the International Association of Assessing Officers in their text titled "Property Assessment and Appraisal Administration" when determining normal net operating income. The following is an example of the format which will be used:

(a)		potential gross rent
	less	vacancy and collection loss
	plus	miscellaneous income
	equals	effective gross income
	less	normal operating expenses
	equals	normal net operating income

(b) Normal and allowable expenses include the costs of property insurance, heat, water, and other utilities; normal repairs and maintenance; reserves for replacement of items whose economic life will expire before that of the structure itself; management and other miscellaneous items necessary to operate and maintain the property.

42.20.109 Capitalization Rates

(1) When using the income approach, the department will develop overall capitalization rates which may be according to use type, location, and age of improvements. Rates will be determined by dividing the net operating income of each property in the group by its corresponding valid sale price. The overall rate chosen for each group is the median of the rates in that group. The final overall rate must include an effective tax rate.

(2)(a) If there are insufficient sales to implement the provisions of ARM 42.20.109 (1), the department will consider using a yield capitalization

rate. The rate shall include a return of investment (recapture), a return on investment (discount), and an effective tax rate. The discount is developed by using a band-of-investment method for types of commercial property. The band-of-investment method considers the interest rate that financial institutions lend on mortgages and the expected rate of return an average investor expects to receive on their equity. This method considers the actual mortgage rates and terms prevailing for individual types of property.

Mr. Blatt selected the cost approach to value when determining the market value for the subject property. At the local hearing he testified, *"...I defaulted to the cost before we ever got to the AB 26 process or the appeal process. Mr. Bashing (sic) discussed this with me. He offered to give me all sorts of information just like Mr. McDonald. I stood on the point that I felt that my cost approach was the approach I was going to use and I really wasn't interested in the income information he was going to send me. I stand by my cost approach. My income information would place a significantly higher value on these properties. I, in my mind, in no way have a problem with my cost approach. In my mind it's a benefit to the taxpayer because it's a lower value. His actual numbers I could take a look and I will take a look at and run them through my own calculations just like I did in the previous appeal. And if this appeal goes any further I'll use that information I obtained there but in my opinion I'm just sticking with the cost. If this appeal goes any further than the County Appeal I will do like I did in the last appeal and use their numbers, decide what I feel is allowable and not allowable and present that information as well..."*(Blatt testimony, pages 24 & 25, Lewis & Clark County transcript). The DOR has contended in this

appeal and previous appeals before STAB that they have had difficulty in obtaining income and expense data from property owners. Based on Mr. Blatt's testimony, he was not even interested in the fact that the taxpayer was willing to supply the DOR with the actual income and expense data. The Board's question to Mr. Blatt is, how can the DOR properly establish income models for income-producing properties if they are not willing to consider or at least analyze income and expense information provided by the taxpayer? This income and expense data could have been compared to the DOR's existing income model for reliability or what Mr. Blatt referred to as "anomalies". In addition, selecting the method of appraisal that has established a lower value does not necessarily **represent** market value.

Mr. Blatt also stated at the local hearing, *"...I agree with your contention that expenses for this type of property are more than your normal expenses for other types of properties. I even conceded in the last appeal. I gave him double what I was giving other properties. But I guess I'm of the opinion that I'm standing on what I have submitted. There is a fee appraisal using the income approach out there. When the Department can use that as evidence. I will then discuss income information. Until then I'm standing on my cost approach and that's where I'm at..."*

As previously mentioned, the DOR presented two fee appraisals conducted on the subject property. And, as previously noted, the final value indications varied approximately \$730,000. The DOR is

mandated to reappraise property statewide and should provide supporting documentation for their value determination.

The owners of the subject property opted out of the HUD program as testified to by Mr. McBurney. While the Board does not know the motivations behind the owners' thinking, one could assume that it may have been profit driven. If the property has been adversely impacted by the HUD 236 program, the value could be less than any of the appraised values presented to this Board since they were based on what has been testified to as market rate projects and not HUD controlled.

A previous management company filed this appeal on behalf of the taxpayer and that representative failed to ascertain land and improvement values on the appeal form. The appeal form filed by the taxpayer's representative stated the value as "To be determined". Between the time of the local hearing and the hearing before STAB the management companies changed, and Mr. McBurney was not the taxpayer's representative before the local board.

The DOR has relied on the cost approach to value for the subject property, Albright v. Montana Department of Revenue, 281 Mont. 169, 1997 states, "*For the valuation of commercial property, CAMAS produces a cost estimate and, in some instances, an income estimate. The income approach to valuation is the preferred method of valuation of commercial properties in Montana.*"(Emphasis added.) It's the Board's opinion, in the course of the hearings, PT-1997-164 (Tower Hill Apartments), PT-1997-165 (Helena Manor Apartments) and PT-1997-166

(Almanor Apartments) there is sufficient evidence to determine appropriate market rents, potential gross income, vacancy and collection loss, operating expenses, net operating income and a total capitalization rate including an effective tax rate, to arrive at an indication of market value from the income approach. The following illustrates the market data gleaned from the evidence and testimony of the aforementioned appeals that will be considered in valuing the subject property:

<u>Income, Vacancy & Expense</u>	
One Bedroom Unit	\$375.00
Two Bedroom Unit	\$400.00
Three Bedroom Unit	\$450.00
Vacancy/Collection Loss	6%
Miscellaneous Income per Unit after vacancy	\$150.00
Operating Expenses (before real estates taxes)	46% of Effective Gross Income
<u>Capitalization Rate:</u>	
Market Capitalization Rate	9.10%
Effective Tax Rate	1.90%
Overall Capitalization Rate	11.0%

Based on the foregoing data, the subject property's market value is:

24 two bedroom units @ \$400.00	\$ 9,600
36 three bedroom units @ \$450.00	\$ 16,200
Total monthly apartment income	\$ 25,800
12 months	X 12
Potential Gross (apartment) Income	\$309,600
Less: Vacancy/Collection Loss (6%)	\$ 18,576
Effective Gross (apartment) Income	\$291,024
Other Income	\$ 9,000
Effective Gross Income	\$300,024
Less: Expenses (46% of EGI)	\$138,011
Net Operating Income	\$162,013

NOI Capitalized @ 11.0%	
\$162,013/11.0%	\$1,472,845

The market value of the subject on a price per unit basis is \$24,547 (\$1,472,845/60). Age, condition, amenities, sale date,

location and unit mix are a few of the characteristics that may suggest a higher or lower value per unit value. Taxpayers' exhibit #1 before the local board illustrates the following sales price per unit along with the accompanying comments:

Location	Sale price per unit	Comments
Missoula	\$26,300	Highly desirable units, best of locations, walking distance to shopping centers, parks, swimming pools and restaurants. Each unit is equipped with range, refrigerator, air conditioner and is serviced by gas hot water heat. Each unit is accessed from both the ground floor and upper level by parking at each level. Landlord pays utilities.
Billings	\$20,833	36 multi-family units (9 four-plexes) with a total floor area of 27,624 sq. feet including 28 two bedroom, 4 one bedroom and 4 efficiency apartments.
Billings	\$31,250	80 unit apartment complex with a swimming pool and garages. These units have been well maintained with new roofs and exterior paint in 1992-93. Property was listed for \$2,650,000 at time of sale. Negotiation brought price to \$2,500,000. Financing did not affect sales price.
Billings	\$28,300	A 30 unit complex with 18 two bedroom units and 12 one bedroom units. Paved parking lot and carports. Tenants are responsible for gas and electric bills. Fair condition at the time of sale. Buildings are 20 years old. Gross building area is 21,294/SF. Lot size is 45,738.
Great Falls	\$40,323	None

It is the opinion of the Board, that the market value of \$1,472,845 or \$24,547 per apartment unit considers the involvement of the government's HUD program.

CONCLUSIONS OF LAW

1. The State Tax Appeal Board has jurisdiction over this matter. §15-2-301 MCA.
2. §15-8-111, MCA. Assessment - market value standard - exceptions.
 - (1) All taxable property must be assessed at 100% of its market value except as otherwise provided.

3. §15-2-301, MCA, Appeal of county tax appeal board decisions. (4) In connection with any appeal under this section, the state board is not bound by common law and statutory rules of evidence or rules of discovery and may affirm, reverse, or modify any decision.
4. Steer Inc. v. Department of Revenue, 245 Mont. 470, 1990.
5. Albright v. Montana Department of Revenue, 281 Mont. 196. 1997.
6. §15-7-111 MCA Periodic revaluation of certain taxable property.
7. §15-2-301 MCA Appeal of county tax appeal board decision (4)...The state tax appeal board may not amend or repeal any administrative rule of the department. The state tax appeal board shall give an administrative rule full effect unless the Board finds a rule arbitrary, capricious, or otherwise unlawful.
8. The appeal of the DOR is hereby granted in part and denied in part and the decision of the Lewis & Clark County Tax Appeal Board is modified.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property shall be entered on the tax rolls of Lewis and Clark County by the Assessor of that county at the value of \$1,472,845 (Land - \$192,510; Improvements - \$1,280,335).

The appeal of the DOR is therefore granted in part and denied in part and the decision of the Lewis & Clark County Tax Appeal Board is modified.

Dated this 29th day of August 2000.

BY ORDER OF THE
STATE TAX APPEAL BOARD

GREGORY A. THORNQUIST, Chairman

(S E A L)

JAN BROWN, Member

JEREANN NELSON, 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 29th day of August, 2000, 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:

Almanor Investors Limited Partnership
c/o Don McBurney
2342 Nordic Loop
Whitefish, Montana, 59937

Office of Legal Affairs
Department of Revenue
Mitchell Building
Helena, Montana 59620

Lewis & Clark County Appraisal Office
City - County Building
316 North Park
Helena, Montana 59623

Lewis & Clark County Tax Appeal Board
c/o Gene Huntington, Chairman
725 North Warren
Helena, Montana 59601

DONNA EUBANK
Paralegal