

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

<p>THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,</p> <p style="padding-left: 40px;">Appellant,</p> <p style="padding-left: 80px;">v.</p> <p>COVENANT INVESTMENTS, INC.,</p> <p style="padding-left: 40px;">Respondent.</p>	<p>)</p>	<p>DOCKET NO.: PT-2009-113</p> <p>and cross appeal PT-2009-116</p> <p>FACTUAL BACKGROUND CONCLUSIONS OF LAW, ORDER and OPPORTUNITY FOR JUDICIAL REVIEW</p>
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This appeal was brought by the Department of Revenue (DOR) from the decision of the Gallatin County Tax Appeal Board (CTAB) reducing the DOR’s valuation of 135 lots of vacant land in the Loyal Gardens subdivision in Bozeman, owned by Covenant Investments, Inc. At the hearing in Helena on May 19, 2011, the DOR was represented by Michele Crepeau, Attorney, Seth Krupar, Industrial Appraiser, Patricia White, Area Manager and John Elliott, Lead Appraiser. The Taxpayer was represented by Michael Green, Attorney, W. Toney Bishop, Jr., Appraiser and DeWin Madill, President and sole shareholder of Covenant Investments. Appendix A, hereby included in this opinion, lists the properties by geocode and address, the value placed on each property by the DOR and the value requested by the Taxpayer and adopted by the CTAB following its hearing. The aggregate value set by the DOR was \$17,600,988 which the CTAB reduced to \$13,745,684.

The Taxpayer filed a cross appeal with this Board to request consideration of further reductions in the 2010 values it had requested from the Gallatin CTAB and had been denied. (Property Tax Appeal Form, June 25, 2010.)

ISSUES PRESENTED

The first issue is whether the CTAB correctly reduced the value set by the DOR in its original appraisal. The second issue is whether the CTAB correctly refused to further reduce the values for the following tax year of 2010.

EVIDENCE PRESENTED

2009 VALUATION

1. The Loyal Gardens subdivision and Covenant Investments, Inc., started in 2005 and final plat of phase 1 was completed and offered for sale in 2007. (Madill Testimony.)
2. Prior to the statutory valuation date of July 1, 2008, four lots had been transferred to purchasers: three single lots for prices ranging from \$95,000 to \$97,900 and one duplex lot for \$125,000. (DOR Exh. C.)
3. In valuing the remaining lots, the DOR relied on a computer assisted land pricing (CALP) model of all vacant land sales in Neighborhood 10, which encompassed much of the city of Bozeman. (DOR Exh. B.)
4. The CALP was based on 190 vacant lot sales that took place in Bozeman from 2006 to July 1, 2008, concluding that the base size of a lot was 14,000 square feet, the base rate was \$9.66 per square foot and the residual rate used to adjust larger and smaller lots was \$7.01 per square foot. The average monthly rate of change was 0.02%. (DOR Exh. B.)

5. None of the four Loyal Garden sales are included in the CALP as they were considered “outliers” because their prices were higher than those in other subdivisions. (White Testimony.)
6. DOR appraisers then prepared an Influence Factor study comparing the four sales to the sales in the CALP and determined that the lots sold for 35% more than the average in other subdivisions. The values calculated for the remaining unsold lots were therefore raised 35% above the Neighborhood 10 CALP in the 2009 valuation. (DOR Exh. C and Krupar and White Testimony.)
7. DOR appraisers testified the influence factor was justified as they considered the Loyal Gardens subdivision an upscale development based on its location on a busy arterial street, trees and water features, and the early sales history. Furthermore, the initial asking prices for lots were higher than other subdivisions. (Krupar Testimony.)
8. The DOR testified that the appraisers learned at the CTAB hearing that one of the four sales was not an arms-length sale and so a second influence factor study was done by Ms. White with the three remaining sales. (DOR Exhibit H.) The result was a 36% influence factor, reaffirming the initial study. Ms. White testified that she had seen influence factors determined with as small a sample as two sales, so did not consider the three sales to be too few to justify the 35% value adjustment. (White Testimony.)
9. Ms. White testified that the DOR calls the buyers to inquire about the nature of the sale before using them in their studies but did not learn of the family relationship that existed between buyer and seller in two of the Loyal Garden sales. Sales between parties who are related or close business associates are not considered arms length and can have either

artificially low sale prices, from a desire to favor the friend or relative, or artificially high prices, in an early effort to create a high typical market price. (White Testimony.)

10. Following the receipt of the appraisal, Mr. Madill filed an AB-26 requesting an informal review with the DOR. He presented appraiser Krupar with an appraisal done by W. Toney Bishop, Jr., which had been done in February 2008 for Valley Bank of Belgrade. Bishop's conclusions of value were substantially lower than the DOR's values. The DOR's values and Mr. Bishop's values are listed in Appendix A as DOR Appraised Value and Original Taxpayer Requested Value. Mr. Krupar made some adjustments to improvements that are not on appeal but declined to change the vacant lot appraisals. (Krupar Testimony.)
11. Following the decision by the DOR, Mr. Madill filed a timely appeal with the Gallatin CTAB, requesting that it adopt the values of the individual lots as set forth in the Bishop appraisal for 2009 and the second Bishop appraisal for 2010 (discussed below). The CTAB granted that appeal for the 2009 valuation but denied the request to further lower the values for 2010. (Appeal Form and Appendix A.)
12. Mr. Krupar testified that he rejected the 2009 Bishop appraisal because it concluded a value based on a discounted lump-sum subdivision-development method under which a discounted cash flow analysis is used to reduce the value by the cost to the developer of holding the property. Furthermore, the sale prices of vacant lots used by Bishop were taken from real estate listings, not the realty transfer certificates used by the DOR, and they were not time trended to the valuation date. He testified that his job was to value each individual lot according to its size using the

CALP methodology as of the valuation date of July 1, 2008. (Krupar Testimony.)

13. DOR appraiser John Elliott stated that the Bishop appraisal appeared to use the same Bozeman Neighborhood 10 sales of vacant lots as the DOR CALP. He said Bishop used averaged prices instead of the more sophisticated regression methods used by the DOR and valued properties by zoning category rather than square footage. He acknowledged that the Bishop square-foot prices were similar to the DOR's but Bishop did not use an influence factor. After closer examination of the appraisal, Mr. Elliott acknowledged that the Bishop appraisal had used a curvilinear regression analysis, not simple averages, and had valued the lots individually as well as the subdivision as a whole, before applying the cash-flow discount for developers. (DOR Exh. I, p. 63.)
14. The DOR appraiser admitted that the 2009 values requested by the Taxpayer and adopted by the CTAB from the Bishop appraisal were the individual lot values calculated without the subdivision considerations. (Krupar Cross Examination.)
15. W. Toney Bishop, Jr., a licensed appraiser with extensive experience and credentials, testified about his appraisal. He was asked by the bank to estimate the value of the subdivision, as a single price of property, if sold to another developer. He started with the individual values of the lots, taken from a regression-analysis study of vacant land sales in Bozeman, estimated the rate of sales and prices and then applied a cash-flow discount to calculate the time cost of holding the lots, to arrive at a value conclusion of \$11,600,000 for the entire subdivision. He stated there was a small downward trend in the market between the time of his appraisal in

February 2008 and the valuation date of July, 2008, but he considered his appraisal values valid for the valuation date. (Bishop Testimony.)

16. The values arrived at by the Bishop Appraisal are quite similar to those derived from the CALP. For example, a 5,000 sq.ft. lot was valued by Bishop at \$69,257 and by the CALP at \$72,000, without the 35 percent influence factor. (DOR Exh I, p. 63.)
17. Mr. Bishop testified that he would expect to see 25 or 35 sales in an area before he would call it a separate market that warranted an influence factor. He stated that two or three sales are not enough as it is common to inflate the early sales and he was sure that was going on in Loyal Gardens early sales.
18. Mr. Bishop testified that it was common for Bozeman subdivisions to have pre-sold one quarter to one third of the lots before the plat was completed but that did not happen at Loyal Gardens, indicating the initial offering price was not a good market price.
19. Mr. Bishop testified that a market “stall” began after October of 2007 as evidenced by the number of days on the market of the lots in Bozeman that sold.
20. DeWin Madill, owner and developer of Loyal Gardens, testified that the property was on a busy street and adjacent to a commercial lot (not part of his development), now a small tree farm, which is for sale. It is also not near any schools. He did major landscaping on the side facing the busy street to overcome some of the traffic noise. (Madill Testimony.)
21. Mr. Madill testified that all four of the early sales were to parents, in-laws and close friends. Several others were transfers to his own construction company. He stated the first market sale to an unrelated party did not occur until October of 2009, following several reductions of the offering

prices for the lots. He agreed that the goal of the sales to his mother and his in-laws was to make the sale prices look high for prospective buyers. Despite aggressive marketing, none sold. (Madill Testimony.)

2010 VALUATION

22. Mr. Bishop submitted a second appraisal, done for the same bank, Valley Bank of Belgrade, on November 3, 2009, which showed a 36.5 percent decline in the fair market value of the property since the February 2008 appraisal to \$7,360,000. (Exh. 6.)
23. The requested 2010 values are included Appendix A in the third column labeled Request to CTAB for 2010.
24. The second appraisal covers the 133 lots remaining at that time. The comparable sales were from the same Bozeman neighborhood during 2008 and 2009, including Loyal Garden sales. The year 2007 was not included because of the lack of sales. (Bishop Testimony.)
25. Mr. Bishop testified that the Loyal Garden lots are not selling at a premium compared to the other subdivisions in Bozeman nor is the decline in market value different from other Bozeman properties. (Exh. 6, p. 64, Bishop Testimony.)
26. Taxpayer submitted settlement sheets from the sales of 18 lots that have sold since October, 2009 to unrelated buyers at prices ranging from \$37,000 to \$45,000, with an average price of \$39,567. For comparison, the first Loyal Garden open market sale, in October of 2009, was for \$39,900 each for two lots that had been valued by the DOR at \$97,605 and Bishop at \$88,825 each. (Exh 4, p. 001 and Appendix A, p. 6.) Other sales showed a greater decline: a lot valued at \$130,254 by the DOR, \$88,825 by Bishop, sold for \$37,500 in May, 2010. (Exh. 4, p. 0013, Appendix A, p. 001.) Another lot valued at \$140,130 (DOR) and \$87,038

(Bishop) sold for \$39,000 in January, 2011. (Exh. 4, p. 0022, Appendix A, p.2.)

27. Taxpayer submitted a study commissioned by the Montana Department of Revenue by Almy, Gloudemans, Jacobs & Denne on January 10, 2011 examining the decline in property values across the state following the valuation in July, 2008 up to June, 2010. That report identifies the decline in Bozeman as 21.9 percent, one of the highest in the state, while “(t)he average property owner in the State has thus seen a modest decline of -2% to -3% since the market peaked in the summer of 2007.” (Exh. 2, Almy, Gloudemans et al, p.10.)
28. The DOR claims that the properties studied in the Almy, Gloudemans report are improved residential lots, not vacant lots, though no specification is given in the report. (Elliott Testimony.)

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. The same method of appraisal and assessment shall be used in each county of the state to the end that comparable property with similar true market values and subject to taxation in Montana shall have substantially equal taxable values at the end of each cyclical revaluation program. (§ 15-7-112 MCA.)

5. A Taxpayer has the right to appeal an appraisal by the DOR by requesting an informal review by the Department or by appealing to the county tax appeal board, within 30 days of the receipt of a notice of appraisal. (§ 15-7-102(3) MCA.)
6. After the first year, the Department is not required to mail a notice of appraisal if the change in valuation is the result of an annual incremental change. (§15-7-102(1)(b) MCA.)
7. 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).
8. The appraised value supported by the most defensible valuation information serves as the value for ad valorem tax purposes. (ARM 42.18.110(12).

**BOARD DISCUSSION, FINDINGS OF FACT
AND CONCLUSIONS OF LAW**

2009 Valuation

First, the Board must determine, based on a preponderance of the evidence, whether the DOR set an appropriate valuation for the subject properties for tax year 2009. Second, the Board must determine whether those values should be adjusted for the 2010 tax year.

As a general rule, the appraisal of the Department of Revenue is presumed to be correct and the Taxpayer 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).

We first look to compare the DOR valuations with those set by the County Tax Appeal Board. The 2009 values set by the Gallatin County Tax Appeal Board were the values developed by the first Bishop appraisal and were similar to those in the DOR's CALP, without the 35% influence factor, although the two studies arrived at their base values with somewhat different methodologies. Thus, the real difference between the two results from the use of the influence factor.

The original influence factor for Loyal Gardens was calculated by the DOR based on the first four sales, and then modified to three sales when one was found not to be arm's length at the CTAB hearing. Uncontroverted testimony at the hearing before this Board established that all four of those first sales were to close friends or relatives and, therefore, were not valid arm's-length sales. Furthermore, the DOR acknowledged that inflating the prices with early sales to family and friends is a common practice, and one which both Taxpayer and Appraiser Bishop agreed was the case at hand. We, therefore, find that the use of an influence factor was based on flawed information, and thus not appropriate in this case.

The values set by the CTAB were taken from the Bishop Appraisal and the question remains whether this Board should affirm those values or the DOR's values, derived from the CALP. No evidence was presented by the Taxpayer that the CALP incorrectly set the base values. It was based on 190 sales in the Bozeman area, a sufficient sample to be statistically reliable and was done in accordance with standard DOR practice. The Bishop Appraisal was done in a professional and competent manner, used a similar data base of sales but a different regression analysis method and distinguished the properties by their zoning, which the CALP does not. Admittedly, the Bishop Appraisal was done for the purpose of valuing the entire subdivision, though valuation of the

individual lots by size was the starting point of that study and the results, at least for some properties, were quite similar. Nonetheless, we conclude that the obligation under law to equalize the treatment of all Montana properties makes it best practice to use the same methodology across the state, and thus the lower values set by the DOR CALP (without the influence factor) are appropriately implemented in this case. We find that the DOR's valuation of the properties, without the influence factor, is a better indication of value for purposes of the state property tax system's 2009 values and modify the CTAB decision accordingly. We therefore order that the DOR modify the Loyal Garden valuations to remove the 35% influence factor for the 2009 appraisal so that the lots are valued under the Neighborhood 10 CALP used to value other Bozeman vacant residential lots.

2010 Valuation

The Taxpayer has asked this Board to further reduce the appraisal values for these lots for the subsequent year, 2010, because values continued to decline. The evidence presented of the actual sales of lots in Loyal Gardens, as well as the second Bishop Appraisal, supports the contention that property values have fallen well below the 2009 values we adopted in the previous paragraph.

The Legislature has created a somewhat complex valuation system for property tax in Montana. As part of that system, all residential property is valued at current fair market value every six years, as of a date certain. *See* §15-7-111, MCA. For the taxable years from January 1, 2009 through December 31, 2014, all class four properties must be appraised at market value as of July 1, 2008. ARM 42.18.124(b). The taxable value set as of July 1, 2008 is then phased-in over the subsequent six year period at the

rate of 16.66% per year. See § 15-7-111(3). Thus, each residential property receives only a single valuation in a six year cycle.

The Montana statutes do not allow for a mid-cycle adjustment in value. Rather, Montana statutes require all land to be valued on the same date in order to produce uniform assessments across the state. *See, e.g.*, §§ 15-7-103(5), 15-7-111(3), 15-7-112, MCA. *See also* Rule 42.18.124(b), ARM. Thus, under current law, the property must be valued for tax purposes on July 1, 2008.

In this case, Taxpayer has won his case for a lower appraisal than the one initially set by the DOR and he now asks that we also initiate a new valuation for 2010 without waiting for the six year reappraisal cycle mandated by §15-7-111 MCA.

Taxpayer claims that because property values in Bozeman have fallen more than most other parts of the state, the six-year appraisal cycle system imposes a disparately heavier tax burden on Bozeman property owners, and thus violates the equal protection requirements of the Montana and Federal Constitutions.

Taxpayer points out that the holding in *Pacificorp v. Montana Dept. of Revenue*, 2010 MT 93, 2011 Mont. LEXIS 127, approved the use of valuation information that occurred after the statutory valuation date, here July 1, 2008. In that case, however, the information – the actual sale price of the company - did not trigger a revaluation but rather reinforced the DOR appraisal value set several months before the sale.

We acknowledge the holdings of various cases that reserve valuation issues exclusively for the tax boards rather than the district courts, but none of those cases conferred on this Board the authority to conduct a mid-cycle valuation. *See Dept. of Revenue v. PPL Montana*, 2007 MT 310, ¶ 45; *O'Neill v. Dept. of Revenue*, 2002 MT 130 ¶ 23; *Dept. of Revenue v. Grouse Mountain*

Development, (1985) 218 Mont. 353, 355, 707 P.2d 1113, 1115. Furthermore, while we heard convincing evidence of 2010 values from the Taxpayer, we heard no specific evidence on the issue from the DOR because the DOR has not done further data studies of the Bozeman area. The Gloudemans study is of a generic nature, and does not provide sufficient specifics to determine how the Taxpayer's valuation compares specifically with other properties.

To adjust values in the middle of the six-year reappraisal cycle, we must find the tax statutes set by the Legislature unconstitutional. We are an administrative Board and hesitate to usurp the authority of the Montana courts and the Legislature by finding statutes to be unconstitutional. In the cases cited to us by Taxpayer in which this Board has found an element of the tax system unconstitutional, it was by applying the holding of the Supreme Court from a similarly situated case. The facts presented here are not parallel, however, to those cases.

In *Sheehy v. Dept. of Revenue*, 1992 WL 137764 (Mont. Tax. App.Bd.), this Board struck down the use of sales assessment ratios and adjustment multipliers that raised the values of all properties in an area with a large number of under-assessed properties. The application of the adjustment multiplier, however, also raised the value of properties in the area that were correctly appraised or over-appraised at the same time, because it applied one adjustment multiplier to the whole area, rather than looking at individual properties and adjusting only the under-appraised properties. The Board applied the rationale of the Supreme Court decision in *Dept. of Revenue v. Barron*, 245 Mont. 100, 799 P.2d 533 (1990) which had found that the use of ratio studies and the application of a multiplier required "certain taxpayers to bear a disproportionate share of Montana's tax burden in violation of the Equal Protection requirements of the Fourteenth Amendment of the United States

Constitution, and Art. II, Sections 17 and 29 of the 1972 Montana Constitution.” *Sheehy*, p.6.

In *Roosevelt v. Dept of Revenue*, 1998 Mont.Dist. LEXIS 824, the district court struck down a state law that required new appraisals to be phased in at 2% per year. Roosevelt’s property had declined in value since the previous appraisal and the court found that the delay in reducing his taxable value forced him to pay higher property taxes than others with property of the same value, and was therefore unconstitutional. Roosevelt, however, was not seeking a reappraisal but was simply seeking to have the routine appraisal immediately effective for his property. In this case, Taxpayer has won his case for a lower appraisal than the one initially set by the DOR and he now seeks a second bite at the apple. He asks that we initiate a new valuation without waiting for the six year reappraisal cycle mandated by Section 15-7-111 MCA.

We conclude that the case presented before us does not provide sufficient legal authority for this Board to determine that the statutory framework set by the Legislature to be unconstitutional.

ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the DOR modify the Loyal Garden valuations to remove the 35% influence factor for the 2009 appraisal.

IT IS FURTHER ORDERED that the Taxpayer's requested values for tax year 2010 are denied.

Dated this 22nd day of July, 2011.

BY ORDER OF THE
STATE TAX APPEAL BOARD

/s/ _____
KAREN E. POWELL, Chairwoman

(S E A L)

/s/ _____
DOUGLAS A. KAERCHER, Member

/s/ _____
SAMANTHA SANCHEZ, 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 25th day of July, 2011, 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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