

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

EXPRESS VENTURES INN,)	
d.b.a., HOLIDAY INN EXPRESS,)	
)	DOCKET NO.: PT-1997-83
Appellant,)	
)	
-vs-)	
)	FINDINGS OF FACT,
THE DEPARTMENT OF REVENUE)	CONCLUSIONS OF LAW,
OF THE STATE OF MONTANA,)	ORDER and OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>
Respondents.)	

The above-entitled appeal was heard on the 7th day of August, 1998 in the City of Missoula, 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. Gregory A. Damico, CPA, representing the taxpayer, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by appraiser Patrick McKenna and appraisal supervisor Jim Fairbanks presented evidence in opposition to the appeal. Testimony was presented, exhibits were received, a post-hearing submission schedule was determined, post-hearing submissions were received, and the Board then took the cause under advisement; and the Board having fully considered the testimony, exhibits and all things and matters presented to it, finds and concludes as follows:

FINDINGS OF FACT

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 subject property is the Hampton Inn and is described as follows:

Tract 1 of Certificate of Survey #4403, City of Missoula, Missoula County, State of Montana; Assessor Code #04-2200-22-4-06-24-0000.

3. The DOR appraised the subject property at a value of \$541,014 for the land and \$2,874,700 for the improvements.

4. On December 12, 1997, the taxpayer appealed to the Missoula County Tax Appeal Board (MCTAB) requesting values of \$541,014 for the land and \$1,652,000 for the improvements, stating, "cost and income approaches do not support re-appraised values. See schedules attached."

5. In a decision dated January 23, 1998, the MCTAB denied the appeal, stating:

The appellant's burden to disprove the DOR's building valuation was not met. The \$2,874,700 value is hereby sustained.

6. The taxpayer appealed that decision to this Board on February 10, 1998, stating:

1997 re-appraised value is not supported by the market as indicated by both actual costs of construction and the income approach to value.

7. At the hearing before this Board the taxpayer revised the requested value for the improvements to \$2,302,211.

8. The Holiday Inn Express is a limited-service hotel which opened for operation in May of 1996 and contains 95 rooms.

9. A post-hearing submission requested by the Board allowed each party an opportunity to provide additional evidence to support their respective capitalization rates.

10. Mr. Damico represents various motel/hotel operators in this series of appeals, therefore, the Board will take administrative notice of the evidence and testimony presented in PT-1997-82, PT-1997-84, PT-1997-85 & PT-1997-86.

TAXPAYER-S CONTENTIONS

Mr. Damico presented the Board with the construction costs for the improvements which totaled of \$2,302,211 (ex #1, pg. 2). Mr. Damico determined that the actual construction costs should be used in establishing the market value because the property is new.

Mr. Damico presented the Board with a value indication from the income approach (ex. 1, pg 1). Summarized, this exhibit illustrates the following.

<u>Income Approach (1997 Results):</u>	<u>Per Cent</u>
Total Revenues	\$1,137,487
Net Income or (Loss)	\$(121,657)
Add:	
Depreciation & Amortization	\$ 289,700
Property Taxes	\$ 66,417
Interest	\$ 248,470

Less:
 Management Fee - @4% \$ (45,499)
 Reserve for Replacement @5% \$ (56,874)
 Net Operating Income \$ 380,556 33.5%
Cap Rate:
 Base Rate 11.0%
 Property Tax Load 1.8%
 Total 12.8%

Indicated Value \$2,973,095 Includes land, Buildings & Personal Property
 Less: Assessed Pers. Prop \$ (246,890)
 Real Estate Value \$2,726,205 Includes Land & Building
 Less: Land Value \$ (541,014)
 Indicated Value - Buildings \$2,185,191

Mr. Damico testified to a 1997 occupancy of 56% and a actual room rate of \$56.63. In 1996 the occupancy was 44% with a \$58 room rate.

Mr. Damico referenced PT-1997-84, exhibit #3, a one page excerpt from **A**Hospitality Investment Survey - PKF Consulting@ for the determination of the selected capitalization rate of 11% (base rate):

Capitalization Rates	Average	High	Low
Full-Service	10.9%	15.0%	8.3%
Limited-Service	11.7%	16.0%	9.0%
Resort	10.4%	13.5%	5.0%

In the taxpayer's analysis, 11.0% has been selected the most appropriate capitalization rate for the subject property.

Mr. Damico's post-hearing submission, with reference for support for the capitalization rate, is a four page document authored by Jinneman, Kennedy, & Associated, P.S., Hospitality Consultants & Appraisers and is summarized as follows:

At your request, we completed certain consulting services regarding the selection of an appropriate capitalization rate for valuing hotels in Montana as of January 1, 1996. For our analysis, we used actual sales activity in Montana and southeast Idaho as one means of estimating an appropriate

capitalization rate. We augmented the regional data with the results of several national surveys of hotel investment criteria. A discussion of each data source and the indicated return requirements are presented in the following paragraphs.

Hotel Industry Investment Surveys

Landauer Hotel Investment Outlook

...The report for the first half of 1996 indicates an average overall capitalization rate for full-service hotels of 9.75 percent, with responses ranging from 7.00 to 13.00 percent. For Limited-service hotels, an average capitalization rate of 11.55 percent was reported, with responses ranging from 10.00 to 14.00 percent.

Coopers & Lybrand/Korpacz Survey

...The 1st quarter 1996 survey indicates an average overall capitalization rate for full service hotels of 10.4 percent, 25 basis points less than the rate indicated in the 4th Quarter 1995 report, and a capitalization rate for limited-service hotels of 12.39 percent, 14 basis points less than the rate indicated in the 4th Quarter report.

HMBA Hotel Financing Survey

The hotel financing survey completed by HMBA lists regional hotel sales transactions by type of owner and hotel size. According to the year-end 1995 report, hotel sales in the Mountain and Pacific region indicated an average capitalization rate of 12.7 percent, ranging from 9.4 percent for hotels with 75 to 250 rooms to 14.5 percent for those hotels with less than 75 guestrooms.

Hospitality Investment Survey - PKF Consulting

The Hospitality Investment Survey, Published by PKF Consulting, provides investment trends based on the expectations of buyers and sellers in lodging industry. In the second quarter of 1996, PKF's survey indicated an average capitalization rate for full-service hotels of 10.88 percent, ranging from 8.0 percent to 11.3 percent. For limited-service hotels, responses ranged from 8.5 to 14.5 percent, indicating an average overall capitalization rate of 11.76 percent.

...On a more regional level, investment in Montana has historically been perceived to carry a somewhat greater degree of risk than would be associated with investment in other areas of the United States. This greater risk is primarily the result of lower investor interest in Montana, Montana's remote location, and overbuilding of hotel properties, including the Missoula market. Accordingly, we would consider an appropriate capitalization rate to be slightly greater than those indicated by national sales data.

Comparable Hotel Sale Properties

Comparable hotel sales in Montana and southeast Idaho were researched and analyzed to provide a more regional indication.

All these sales were researched and analyzed while our firm was completing appraisals of hotels in Montana. These sales were confirmed with the broker, the seller, or the buyer. Capitalization rates were computed by dividing the net operating income, after deduction of an appropriate property management fee and capital replacement reserve, by the sale price. Additional details of these sales are available from our office. The overall capitalization rates derived from the unadjusted comparable sales are summarized in the following table.

Table 2					
Summary Of Comparable Hotel Sale Indicators					
Property	Location	Sale Date	Year Built	Cap Rate	
<i>Full-Service Hotel Sales</i>					
Ponderosa Inn	Great Falls, Montana		1969	Jun-91	10.9%
Best Western Canyon Springs	Twin Falls, Idaho		1973/1984	Aug-95	14.4%
Townhouse Inn	Great Falls, Montana		1972/1984	Feb-92	13.3%
Best Western War Bonnet Inn	Butte, Montana		1973/1977	Mar-93	11.2%
Best Western Colonial Inn	Helena, Montana		1970/1986	Apr-96	11.3%
Quality Inn	Pocatello, Idaho		1978	Mar-94	16.0%
<i>Limited-Service Hotel Sales</i>					
Super 8 Motel	Miles City, Montana		1978	Feb-92	12.4%
Super 8 Motel	Glendive, Montana		1978/1986	Mar-93	11.8%
Super 8 Motel	Whitefish, Montana		1989	Aug-93	15.0%
Best Western AmeriTel Inn	Idaho Falls, Idaho		1991	Jun-96	13.7%

The overall capitalization rates extracted from the above sales data indicate a range of unadjusted capitalization rates from 10.9 to 16.9 percent. These sales include both limited and full-service hotels and do not include sales of distressed properties. These capitalization rates are supported by the industry surveys, which indicate average overall capitalization rates from 9.75 to 12.70 percent, but also reflect the greater risk associated with the hotel industry in Montana.

Hotels are a unique type of real estate investment that carry risks and benefits not found in many other types of real estate investment. Unique characteristics of hotels include:

- , A large amount of personal property (furniture, fixtures, and equipment) necessary for operation.
- , The retail nature of operation, including the need to re-sell rooms on a daily basis and the labor intensity of the business.
- , Rapid functional obsolescence due to increased market segmentation in the industry.
- , Susceptibility to external factors, such as changes in the market area conditions or modes of travel, which can immediately affect the operating performance of a hotel.

, Specialized nature of a hotel, which limits the number of potential buyers.

, Potential for large profits once fixed costs are covered.

, Because guestrooms are re-sold on a daily basis, changes in market conditions affect more rapidly than most other types of real estate. Accordingly, more risk is assumed in investment than with other real estate investments, and higher capitalization rates are indicated on investment surveys completed by Cushman & Wakefield and Dupre & Scott, typical capitalization rates on office properties in January 1996 averaged 9.0 percent, while typical capitalization rates on residential properties averaged 8.3% percent. These rates are approximately 200 to 850 basis points as indicated by the actual comparable hotel sale data, demonstrating the additional risk associated with investments in Montana.

DOR-S CONTENTIONS

DOR exhibit A is a copy of the property record card and illustrations with respect to the improvements:

Structure

, Year built - 1996
, Number of units - 97
, Quality grade - Good -
, Building area
 1st floor - 10,728 square feet
 2nd floor - 10,728 square feet
 3rd floor - 10,634 square feet
 4th floor - 10,634 square feet
, Physical condition - 3 (average)
, Functional utility - 2 (fair)
, Percent good - 97% (accumulated depreciation - 3%)
, Economic Condition Factor (ECF) - 100%

Other Building and Yard Improvements

, Paving (asphalt) - 80,000 square feet - \$87,850
, Canopy - \$14,280

DOR exhibit B in PT-1997-85 is a four page document that the DOR

incorporate in appeals PT-1997-82, 83, 84 and 86. Mr. Fairbanks stated created by DOR appraiser, Sue Hoell. In summary, this exhibit illustrates

FIVE LARGE VERY GOOD QUALITY MOTELS - 1997				
Property	Holiday Inn Parkside	Best Western Grant Creek	Ruby's Reserve Street Inn	Holiday Inn Express
Year Built	1984	1996	1981	1996
Building Area	136,960	81,208	67,020	42,724
# of Rooms	200	126	127	95
Room Rate	\$56	\$63	?	\$55
Occupancy	71%	60%	?	50%
Room Income	\$2,918,832	\$1,738,422	\$1,752,563	\$953,563
Telephone Income	\$17,479	\$6,419	\$0	\$3,923
Other	\$67,730	\$0	\$0	\$14,746
Total Income	\$3,004,041	\$1,744,841	\$1,752,563	\$972,232
Total Expenses	\$2,366,591	\$1,180,887	\$1,430,583	\$572,393
Net Income	\$637,450	\$563,954	\$321,980	\$399,839
Value @ 9.5%	\$6,710,000	\$5,936,358	\$3,389,263	\$4,208,826
Value @ 13%	\$4,553,214	\$4,338,108	\$2,476,769	\$3,075,681
Pers Property(PP)	\$317,862	\$682,521	\$183,658	

Value 1 Less PP	\$6,392,138	\$5,253,837	\$3,205,605	\$4,208,826
Value 2 Less PP	\$4,235,352	\$3,655,587	\$2,293,111	\$3,075,681
Estm Rpl Cst Less Depr	\$7,097,782	\$5,930,640	\$3,570,166	\$3,415,714
Assessed Value	I \$6,823,800	C \$5,930,640	I \$3,470,500	C \$3,415,71
Value Per Room	\$21,177	\$29,013	\$18,056	\$32,376

The exhibit states further, ...The tax rep provided the department with Income and Expense statements from each of the five hotels along with a summary sheet on which he attempted to identify the main income and expense items which he felt were important to address. I cannot explain the numbers on his summary but they differ from the numbers I derived from the information provided by the owners.

I believe Mr (sic) Damico said that the income on his summary came from actual income but the expense numbers came from industry standards. To use a different standard for income than is used for expenses I believe is an error. If we use actual income, (sic) we must also use actual expenses. That is the approach we used.

I found the industry standards to be unreliable, conflicting and usually unsupportable.

The hospitality trade materials don't provide detailed support for their ratios, but it is likely that they influence the market regardless of the quality of their methodology...

...The trade materials differentiate ratios by region - New England, Mountain, Pacific, etc. Their data is primarily derived from property management firms operating in large metropolitan areas rather than small communities like Missoula.

A 14% cap rate was used by the agent although an 11% cap rate was suggested in the industry literature he provide. We used his 11% cap rate assuming that these larger motels are likely to be marketed in a national rather than a local market. We added to the 11%, our 2% tax rate.

We disallowed some of the expenses listed on the Income and Expense statements where such expenses did not contribute to the generation of income, such as bank charges, loan amortization and interest, cost of food for the restaurants, and unidentifiable categories such as the one listed by Best Western called **Acollateral materials@**. Non-typical expenses were disallowed.

Both in our original appraisal process and in our review of values, we used only information gathered from the Missoula motel community. In the later analysis, we used only the information provided by these hotel owners.

Five Missoula motels sold during the time frame of our reappraisal period. Income and Expense ratios were normalized for the Missoula area. Market I&E ratios and market cap rates were applied to each hotel/motel in the county to arrive at a value using the income approach.

The five larger motels have lower expense ratios than the smaller motels from which we derived our ratios.

The local market capitalization rate for the smaller motels is 9.5%.

Because much of the information we originally used came from small

motel owners, it was decided that we would build a new model using the local information provided by the tax rep for the larger hotels....

The Hampton Inn, the smallest of the five, is of a higher quality construction than the Holiday Inn Express and Ruby's. It is next door to Ruby's and under the same ownership. There is a symbiotic relationship between the two facilities enhancing income for both.

The Hampton Inn may have been slightly undervalued by the department.

The value arrived at using the Income approach was used whereas the intent was to assess all the new motels using the cost approach.

The cost approach is the most appropriate approach for new commercial uses. It is clear that the developers were persuaded to invest the money required to build these hotels. They felt the cost was a fair representation of value when they made the decision to build which was just prior to our date of appraisal.

Furthermore, in the first year of operation, occupancy rates and room rates are unstable. There are extra set-up costs, and advertising has not had a chance to take effect. That is why the cost approach is felt to represent the most accurate approach to value for new commercial properties.

The income approach on the Hampton Inn using the 13% cap rate, supports the income value arrived at earlier using the original set of market information. An upward adjustment may be made next year for equity reasons if the legislative and administrative rules allow us to make such a correction...

Because of the strong hospitality market in Missoula, 2 more large new motels are being built for '98.

Mr. McKenna testified, "One of the reasons why Ms. Hoell developed this presentation was because she wanted to look at the reasonableness of our numbers versus the reasonableness of the numbers that Mr. Damico supplied us. And as you have noticed in many cases they are very similar, the net operating incomes are very similar, so Sue drew the conclusions that since that wasn't a vast difference we should stick with our numbers."

The DOR's market value of \$2,874,700 for the improvements was determined by the cost approach to value. Mr.

McKenna testified the cost approach to value is most applicable when the properties are new and little depreciation need be applied.

Exhibit A is the DOR's value determination from the income approach and, in summary, illustrates the following:

Income Portion

Base Rate	=	\$55.00
Market Type (Commer)	x	1.25
Quality Type (Good)	x	1.10
Amenities No Pool	x	.95
Adjusted Base Rate	=	\$71.84
x number units	x	97
x number days	x	365
Potential Gross Income	=	\$2,543,495
Occupancy Predicted	x	60%
Effective Gross Income	=	\$1,526,097
Expenses 75% of Gross Income	=	\$1,144,572
Total Expenses	=	\$1,144,572
Net Income	=	\$381,525
Income Capitalization		
Equity Ratio 1.00 x cash on cash	0.095 =	0.095
Effective Tax Rate	=	0.0215
Total Capitalization Rate		0.1165
Net Income 381,525 @ 0.1165		
Value, Income Approach	\$3,274,900	
Residual Land	\$	420,000
Adjusted Value Income App.	\$3,694,900	
Cost	\$3,415,714	
Income	\$3,694,900	
Ratio		8%

Mr. Fairbanks testified (PT-1997-84) that, when establishing the capitalization rate, the DOR had a sufficient number of motel sales to develop an acceptable capitalization rate. Based on their confidence in this rate, the band-of-investment theory was not utilized as defined in 42.20.109.

Mr. McKenna testified (PT-1997-84) that, when the DOR is in the process of establishing their cost tables, builders and contractors are contacted to obtain actual construction costs for various projects across the State. Mr. McKenna stated that Mr. Damico presented the DOR with the construction costs for the subject property, but the DOR had a high confidence level in its own established costs; therefore, in the final determination of value, the DOR considered its own costs.

Mr. Fairbanks indicated (PT-1997-84) when the income models were created, the income was adjusted to reflect the portion attributable to personal property, (i.e. beds, televisions, etc.). He stated the nightly rent or room rate was discounted to reflect this amount.

DOR's exhibit B in PT-1997-84 that has been made a part of the record is a compilation of motel/hotel properties that have sold along with the DOR's market value indications for this series of appeals. This exhibit is summarized as follows:

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Comparable Sales						
	Yr. Built	Grade	# Units	Sale Date	Sale Amount	Per Unit
Sale #1	1982	A+	115	9/95	\$3,488,077	\$30,331
Sale #2	1981	A	117	4/94	\$3,740,000	\$31,966
Sale #3	1995	A+	52	9/95	\$1,900,000	\$36,538
Sale #4 *	1978	G	220	4/98	\$9,000,000	\$40,909
Sale #5 *	1972	A+	124	2/98	\$7,140,000	\$57,581
Sale #6 *	1970	G	149	4/96	\$9,150,350	\$61,412
Properties Under Appeal						
	Yr. Built	Grade	# Units		Appraised Value	Per Unit
Ruby's (97-86)	1988	A+	132	N/A	\$3,470,500	\$26,292
Holiday Inn Parkside (97-82)	1984	G+	200	N/A	\$6,823,800	\$34,119
Holiday Inn Express(97-83)	1996	G-	97	N/A	\$3,415,714	\$35,214
Grant Creek Inn (97-84)	1996	G	130	N/A	\$5,930,640	\$45,620
Hampton Inn (97-85)	1996	G	60	N/A	\$2,760,300	\$46,005
* full service facility						

Mr. Fairbanks testified (PT-1997-84) the DOR does not

market model commercial properties to determine market value.

Exhibit B was presented to illustrate the comparison of sold properties on a price per unit (sale price/number of rooms) with the DORs per unit value of the properties under appeal (DOR market value/number of rooms).

Mr Fairbanks testified (PT-1997-84) that daily rates and occupancy rates are not difficult to obtain, but net operating income from properties which have sold is not so easily ascertained; therefore, the DOR will create or normalize the income and expenses in order to establish the net operating income. This net operating income is then used to develop a capitalization rate.

The DORs post-hearing submission illustrates the following in support of the 9.5% capitalization rate before applying the effective tax rate:

MARKET-BASED CAP RATES FOR MISSOULA COUNTY MOTELS					
Taken from RTCs and income/expense reports					
Sale #	#1	#2	#3	#4	#5
Sale Date	September '95	April '95	April '93	May '93	February '93
Sale Price	\$1,900,000	\$325,000	\$500,000	\$347,500	\$170,000
Net Income	\$180,500	\$29,920	\$47,158	\$35,000	\$16,660
Cap Rate	9.50%	9.21%	9.43%	10.00%	9.80%

DISCUSSION

The Administrative Rules of Montana (ARM) provides that the DOR establish market value from the income approach.

ARM, 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 the necessary information is available, an income approach valuation.

(2) If the department is not able to develop an income model with a valid capitalization rate based on the 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)

ARM, 42.20.108 Income Approach.

(1) The income approach is based on the theory that the market value of income producing property is related to the amount, duration, and certainty of its income producing capacity. The formula used by the department to estimate the market value of income producing property through application of the income approach to value is $V = I/R$ where:

(a) Av@ is the value of the property to be determined by the department;

(b) AI@ is the typical property net income for the type of properties being appraised; and

(c) AR@ is the capitalization rate determined by the department as provided in ARM 42.20.109. (emphasis supplied)

ARM, 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 rate must include an effective tax rate. (emphasis added)

(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 using a band-of-investment 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.

(b) A straight-line recapture rate and effective tax rate will be added to the discount rate to determine the yield capitalization rate.

The taxpayer's net operating income (NOI) from exhibit #1 is \$380,556 and the DOR's NOI from exhibit B is \$381,525. The major disparity between the party's income approaches lies with the determination of an appropriate capitalization rate. The taxpayer capitalized the NOI at 12.8% (11.0% - base rate + 1.8% - effective tax rate) and the DOR capitalized the NOI at 11.65% (9.5% + 2.15% effective tax rate). The Board requested that each party provide additional support for their respective capitalization rates through a post-hearing submission. The taxpayer's support for its capitalization rate was provided by JK & Associates, Hospitality Consultants & Appraisers. The DOR's support for its capitalization rate was provided by five additional motel sales. The post-hearing submissions have been submitted for the immediate appeal and appeals PT-1997-82, 84, 85 & 86. The appeals are for limited-service motels as well as full service motels. The Board notes that capitalization rates may vary depending upon the type of motel property along with all the additional components that affect value, i.e. age, condition,

location, etc.

The DOR testified (PT-1997-84), when determining the capitalization rate from properties that have sold, the NOI's for those sales were created rather than using properties' actual NOI's at the time of sale. It is the Board's opinion that an actual NOI should be used if possible when establishing a capitalization rate. The Board realizes that adjustments may need to be made to the reported NOI, i.e. taxes, management, reserves for replacement, etc. It is the Board's opinion that simply creating an NOI does not reflect an actual capitalization rate for the various sales. In addition, the Board was not presented evidence explaining how the various NOI's were created.

The DOR adjusts the value of the improvements as determined by the cost approach by an ~~A~~Economic Condition Factor~~@~~ (ECF). The ECF is a market adjustment factor. The International Association of Assessing Officers (IAAO) states:

Market adjustment factors are often required to adjust values obtained from the cost approach to the market. These adjustments should be applied by type of property and area based on sales ratio studies or other market analyses. Accurate cost schedules, condition ratings, and depreciation schedules will minimize the need for market adjustment factors. (IAAO, 1990, Property Appraisal and Assessment Administration, pages 311-312)(Emphasis applied)

An ECF for a neighborhood is derived from sales. The Board is puzzled as to why this property has an ECF of 100% while the

other four properties in this series of appeals have ECFs of 105%. It was testified in PT-1997-84 that the ECF was determined from sales of all commercial property. Mr. Fairbanks testified **A**...it might be much more appropriate to specifically identify an ECF for specific occupancy.@ Mr. Fairbanks further testified, **A**I don't think we had enough sales to identify an ECF for occupancy.@

The DOR in PT-1997-84, exhibit B presented the Board with six motel property sales. This exhibit compares the DORs value indications for the five motel properties represented by Mr. Damico with six motel property sales. The properties vary in comparability (i.e., full-service, limited service, age, size, location, etc). The DOR presented this exhibit to illustrate what motel properties are selling for on a price per motel room.

Motel properties can be viewed as having a **A**going-concern value@, defined in the Appraisal of Real Estate, 11th Edition, as:

Going-concern value is the value of a proven property operation. It includes the incremental value associated with the business concern, which is distinct from the value of the real estate. Going-concern value includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. Going-concern value refers to the total value of a property, including both real property and intangible personal property

attributed to business value.

Going-concern appraisals are commonly conducted for hotels and motels, restaurants, bowling alleys, industrial enterprises, retail stores, shopping centers, and similar properties. For these properties, the physical real estate assets are integral parts of an ongoing business. It may be difficult to separate the market value of the land and the improvements from the total value of the business, but such division of reality and nonreality components of value is often required by federal regulations. (emphasis added)

The Board realizes the sales illustrated and used by the DOR for comparison purposes may, in fact, reflect the inclusion of **A**going-concern values and the DOR is appraising for ad valorem purposes. The DOR did not establish the market value for the subject property by the sales comparison approach to value, but the sales illustrated would need to be adjusted for the inclusion of personal property, excess land, business inventory, liquor/gaming license and intangibles that may have been included in the transaction.

The subject property was built during 1995 and 1996; therefore, it is new construction for the current appraisal cycle. The Board agrees with both parties that the cost approach to value is most effective in determining market value for new properties. The Appraisal of Real Estate, 11th Edition, states:

AThe cost approach is based on the understanding that market participants relate value to cost. In the cost approach, the value of a property is derived by adding the estimated value of the land to the current cost of constructing a reproduction or replacement

for the improvements and then subtracting the amount of depreciation (i.e., deterioration and obsolescence) in the structures from all causes. Entrepreneurial profit may be included in the value indication. This approach is particularly useful in valuing new or nearly new improvements and properties that are not frequently exchanged in the market. (emphasis added)

Both parties presented the Board with market value indications for the improvements from the cost approach. In addition, both parties presented the Board with market value indications from the income approach to value to support their respective value indications from the cost approach. The DOR's value indication from the cost approach was developed from the DOR's cost tables. The DOR stated that, within the income model for motel properties, the income has been reduced for the existence of the motels' personal property. The taxpayer's requested value was presented as the actual construction cost. The taxpayer's income approach indication was developed from the actual 1997 operating statement. It may not be appropriate to use the actual income and expense data for a property that has only been in operation for a year and a half at the time the appeal was filed, and the cost approach might be the best indicator of market value.

Mr. McKenna stated in the post-hearing submission:
AThe courts have ruled (Western Airlines Versus Michonovich 149 Montana, page 347 (1967) that the burden of disproving the DOR's valuation rests with the appellant, and that there is a

presumption of correctness in the DOR's appraisal.@ This statement is correct but incomplete. The courts decision further stated A...the taxing agency should bear a certain burden of showing the propriety of their action.@

Mr. McKenna also stated in his post-hearing submission: AIndeed, Mr. Damico testified under oath before the Missoula County Tax Appeals Board that, after considerable review, the properties were not properly appraised and should be valued at one level, and then testified under oath to STAB that, after considerable review, the properties were not properly appraised and should be valued at a higher value. The DOR's valuation has never wavered.@

This Board has always dealt with and allowed a modification of the values requested by the taxpayers. There are any number of reasons that could warrant such a modification following an appearance before a local tax appeal board. A change in the requested value does not constitute an inconsistency or a contradiction of prior testimony that could be seen as an unfair surprise to the DOR, particularly in this case since the requested value was increased from that requested by the taxpayer before the local tax appeal board.

Mr. McKenna was provided the opportunity of examination of Mr. Damico and his exhibits and to draw from those the inconsistencies Mr. McKenna may have believed existed. It is

unclear why that issue was raised in a post-hearing submission.

In Department of Revenue v. BN Inc., 169 Mont. 202, A..while STAB reviewed the assessment (as it may under section 84-708(3), R.C.M. 1947), augmenting the record so it might better perform its duty, as stated in section 84-709:

A *** to affirm, reverse or modify any decision appealable to the state tax appeal board ***@.

To perform this function, STAB may have a completede novo hearing, for the infrequent case in which the board is of the opinion that if should examine all of the record of the Department, and additional evidence, on a firsthand basis, so as to reach a fair, just and equitable holding..@ (emphasis added)

Based on the evidence and testimony presented to the Board, the market value for the subject improvements, Holiday Inn Express, shall be the actual construction costs of \$2,302,211 as presented by the taxpayer.

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. **Western Airlines, Inc. v. Catherine J. Michunovich, et al, 149 Mont. 347.428 P.2d 3.(1967).**

5. **Department of Revenue v. BN Inc., 169 Mont. 202.**

6. Evidence and testimony in PT-1997-82, PT-1997-84, PT-1997-85 & PT-1997-86.

7. The appeal of the taxpayer is hereby granted and the decision of the Missoula County Tax Appeal Board is reversed.

ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject improvements shall be entered on the tax rolls of Missoula County by the County Assessor at the 1997 tax year value of \$2,302,211.

Dated this 23rd of December, 1998.

BY ORDER OF THE
STATE TAX APPEAL BOARD

PATRICK E. McKELVEY, Chairman

(S E A L)

GREGORY A. THORNQUIST, Member

LINDA L. VAUGHEY, 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.