

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF MONTANA,)	DOCKET NO: PT-1997-164
)	
Appellant,)	
)	
-vs-)	
)	FINDINGS OF FACT,
JOSEPH B. REBER & SONS)	CONCLUSIONS OF LAW,
PARTNERSHIP,)	ORDER and OPPORTUNITY
)	<u>FOR JUDICIAL REVIEW</u>
Respondent.)	

The above-entitled appeal was heard on May 22, 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 Greg MacDonald, Tamarack Property Management Company, presented testimony in opposition thereto. Testimony was presented and 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 the subject of this appeal is described as follows:

Lots 15-20, part of lot 35, lots 36-39 and lots 52-56, Block 31, Helena Original Town site, City of Helena, Lewis & Clark County, State of Montana and improvements located thereon. Assessor number - 5876.
3. For the 1997 tax year, the DOR appraised the subject property at a value of \$59,200 for the land and \$1,289,900 for the improvements.
4. The taxpayer timely filed an AB-26 Property Adjustment Form on October 1, 1997 requesting an informal meeting with the DOR to discuss the taxpayer's opinion of the market value.
5. DOR appraiser Don Blatt denied an adjustment to 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 & Clark County Tax Appeal Board on March 13, 1998, requesting the land be valued at \$72,039 and the improvements at \$984,000, stating:

Value as determined by the Department of

Revenue is too high and exceeds market value.

7. In its June 5, 1998 decision, the county board granted the taxpayer's requested values, stating:

DOR failed to provide justification of capitalization rate.

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 \$1,349,100 was established from the income approach to value. (exhibit K)
10. The taxpayer's granted value of \$1,056,039 is the value indication from the previous appraisal cycle. (exhibit B)
11. The Board's decision has considered the evidence and testimony presented in PT-1997-165, DOR v. Helena Partners Limited Partnership and PT-1997-166, DOR v. Almanor Investors Limited Partnership.

DOR'S CONTENTIONS

The DOR's property record card (PRC), Board exhibit #1, suggests a land area of 72,039 square feet. The two independent fee appraisals suggest an area of 69,923 square feet. Exhibit J indicates that a portion of the subject property was sold in 1992. Mr. Blatt agreed that the property record card should reflect a land area of 69,923 square feet as indicated in the fee appraisals. The DOR has determined a price per square foot for the land at \$.82

per square foot.

The DOR has selected the income approach (direct capitalization) method as the appraisal technique in determining the market value. This method does not segregate a portion to land and improvements; rather, it establishes a total property value. Therefore, a change in land area would only affect the allocation of value to land and improvements. Considering the DOR's direct capitalization method, the allocated values to land and improvements would be as follows:

	<u>(PRC)</u>	<u>(Corrected area)</u>
Land area (SF)	72,039 SF	69,923 SF
Price per SF	<u>\$.822 SF</u>	<u>\$.822 SF</u>
Land value	\$59,200	\$57,477
Less: Total value	<u>\$1,349,100</u>	<u>\$1,349,100</u>
Improvement value	\$1,289,900	\$1,291,623

Exhibit K is the DOR's income model and summarized illustrates the following:

15 1 BEDROOM	@	300	=	4,500
31 2 BEDROOM	@	375	=	11,625
5 3 BEDROOM	@	430	=	<u>2,150</u>
TOTAL			=	18,275
TWELVE MONTHS			X	<u>12</u>
TOTAL			=	219,300
POTENTIAL GROSS INCOME			=	219,300
PERCENT OCCUPANCY			X	<u>90</u>
INCOME AFTER OCCUPANCY			=	197,370
EFFECTIVE GROSS INCOME			=	197,370
TOTAL EXPENSES			=	47,623
MANAGEMENT			=	0
TOTAL			=	(47,623)
NET INCOME			=	149,747

INCOME CAPITALIZATION				
EQUITY RATIO	1.00 X CASH ON CASH	0.111	=	0.111
EFFECTIVE TAX RATE				<u>0.0000</u>

TOTAL CAPITALIZATION RATE			0.111
NET INCOME	149,747	@	0.111
VALUE, INCOME APPROACH			1,349,100 9 (rounded)

The DOR's value indication from the cost approach is \$1,484,000. It is Mr. Blatt's opinion that the income approach value is the best indication of market value.

DOR exhibit F is entitled "PROCEDURE FOR FEDERALLY SUBSIDIZED HOUSING". Summarized, this exhibit states the following:

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.

DOR exhibits H and I are separate independent fee appraisals for the subject property. In summary, these appraisal reports, along with the DOR's value conclusions, illustrate the following:

Appraiser	DOR (various exhibits)	White (exhibit H)	Jette (exhibit I)
Date of Value	1/1/96 (Bd. Ex. #1)	8/1/97	1/12/2000
Property Rights Appraised		Fee Simple Estate	Fee Simple Estate
Land Value	\$59,200 (Bd. Ex. #1)	\$122,400	\$140,000
Personal Property Value	\$14,370 (Ex. B)	\$41,250	\$14,688
Market Value – Cost Approach	\$1,484,000 (Ex. K)	\$1,453,600	\$1,040,000
Market Value – Income Approach	\$1,349,100 (Ex. K)	\$1,396,500	\$1,078,000
Market Value – Sales Comparison Approach		\$1,400,000	\$1,025,000
Final Value Estimate	\$1,349,100 (Bd. Ex. #1)	\$1,400,000	\$1,078,000
Function of the Appraisal	Ad Valorem Tax (Ex. K)	Estate planning	Estate planning & tax appeal
Unit Mix	51 rental units	50 rental units	50 rental units

Appraiser	DOR (various exhibits)	White (exhibit H)	Jette (exhibit I)
	1 bedroom – 15 2 bedroom – 31 3 bedroom – 5	1 bedroom – 15 2 bedroom – 30 3 bedroom - 5	1 bedroom – 15 2 bedroom – 30 3 bedroom - 5
Monthly Rents	(Ex. K) 1 bedroom - \$300 per month 2 bedroom - \$375 per month 3 bedroom - \$430 per month	1 bedroom - \$350 per month 2 bedroom - \$450 per month 3 bedroom - \$550 per month	1 bedroom - \$400 per month 2 bedroom - \$466 per month 3 bedroom - \$590 per month

DOR exhibit S, titled "*Apartment Analysis*" is a compilation of 70 income and expense surveys that were returned to the DOR by the individual property owners. The DOR used this information when creating the income approach. Of the 70 surveys, nine of the properties were involved in a sales transaction. Mr. Blatt testified that, based on the sales illustrated on exhibit S, a total capitalization rate of 11.1% was determined for apartment property in neighborhood #215, in which the subject is located.

TAXPAYER'S CONTENTIONS

The taxpayer's requested values before the Lewis & Clark County Tax Appeal Board, and subsequently granted, are the market values from the prior appraisal cycle (exhibit #3). Mr. MacDonald testified that nothing occurred with the subject property to suggest an increase in the market value from 1996 at \$1,056,036 to \$1,349,100 in 1997.

Exhibit #4 describes the subject property as follows:

Three (3) buildings consisting of 50 apartments:

- 15 One Bedroom Apartments containing 565 square feet each
- 30 Two Bedroom Apartments containing 663 square feet each
- 5 Three Bedroom Apartments containing 927 square feet each

Parking spaces:

- 63 automobile spaces

One Laundry Room

One Site Office

Landscaping:

Perimeter grass
Minimal trees and shrubs

Amenities: None, other than a sandbox

Special Features: None

Heat: Baseboard electric

Age: Built in 1977

Physical Condition: Below Average

Deferred Maintenance: Significant

Housing and Urban Development (HUD) Requirements:

Section 221-D (4): Loan insurance

Section – 8 subsidy: 36 units (tenants pay up to 30% of their income toward rent payment, remainder is subsidized by HUD) (HUD determines rent level) (Section – 8 subsidy will expire in September, 1998)

Reserve for replacement requirement by HUD:

\$1,750 per month or \$21,000 per year. A reserve of this nature is intended to fund future depreciation of the apartment complex.

Conventional Rent Apartments: 14 units

Rent levels of the conventional units cannot be less than HUD determined rent levels

Cash Distribution to Owner:

1992	\$0
1993	\$0
1994	\$0
1995	\$0
1996	\$7,100
1997	\$7,800

Exhibits #5 - #9 consist of sales of multifamily complexes.

Summarized, these exhibits illustrate the following:

Exhibit #	#5	#6	#7	#8	#9
Location	Missoula	Billings	Billings	Billings	Great Falls
Date of Sale	4/29/94	7/15/94	8/11/94	9/16/96	3/11/97
Purchase Price	\$1,315,000	\$750,000	\$2,500,000	\$849,000	\$1,250,000
# of Units	50	36	80	30	31
Year Built	1972	1977	1977	1976	1977
Income Data					
Gross Income	\$226,500	\$161,513	\$475,300	\$150,300	
Less: Expenses	<u>\$ 84,214</u>	<u>\$ 83,483</u>	<u>\$198,500</u>	<u>\$ 61,340</u>	
Net Operating Income	\$140,036	\$ 78,030	\$276,800	\$ 88,960	\$139,273
Gross Income Multiplier	5.8	4.6	5.2	5.6	
Overall Rate	10.6%	10.4%	11.1%	10.5%	11.14%

Mr. MacDonald testified that aforementioned sales were not HUD controlled and are superior in comparison to the subject property. The subject being an inferior property would suggest a capitalization rate greater than 11.1%.

The following table compares the income and expenses for the year 1995 (exhibit #12) and the DOR's income approach for the subject (exhibit #13)

Exhibit #	#12 - Taxpayer	#13 - DOR
Total Income	\$244,771	\$197,370
Expenses	\$127,602	\$47,623
Net Income	\$117,169	\$149,747

Mr. MacDonald testified that the actual income and expense data for the subject property was presented to the DOR prior to the hearing before the Lewis & Clark County Tax Appeal Board. The taxpayer and the DOR could not come to an agreement; therefore, the matter was appealed to the local board.

Exhibit #15, "*Procedure for Federally Subsidized Housing*", was provided to the taxpayer by the DOR to illustrate how the DOR appraises federally subsidized housing. Mr. MacDonald testified

that the income statement (exhibit #12) reflects the benefits to the subject property through rent subsidies. Mr. MacDonald offered further testimony that, under the Section 221-D4 HUD program, which is the HUD program controlling the subject property, the loan to value ratio will vary from a typical conventional loan. Typically, the loan to value ratio for a 221-D4 is 90% loan and 10% equity, with the loan being guaranteed. The interest rate on the mortgage would not vary from conventional rates. Mr. MacDonald offered his opinion that, based on the property today, an investor for Tower Hill would require a return on his investment in excess of 12%. In 1977, Mr. MacDonald testified that the interest rate on the loan was approximately 9.75%; and, in 1996, long-term mortgage interest rates were obtainable at a lower rate.

Mr. MacDonald is of the opinion that the DOR neglected to follow its policy in appraising the subject property as stated in exhibit F.

Exhibit #17 is an appraisal on the subject property as of January 12, 2000, with a final value indication of \$1,078,000 by Garold Jette. This appraisal was done in preparation for the appeal before this Board.

Mr. MacDonald testified that the subject property has extensive deferred maintenance, i.e., parking lot, exterior paint, windows, roof covering, and interior decorating. The Jette report, exhibit 17, estimates the deferred maintenance in the amount of

\$350,000.

As mentioned, there are several items of deferred maintenance. The total estimated cost for these items, as per estimates in the Addendum section of this report, is approximately \$350,000.

Although the subject has had maintenance and renovations through the years, the effort has not kept pace with accrued physical deterioration, and the subject suffers more than average physical depreciation. Typically, with good maintenance and renovation, effective age is less than actual age as the years pass. In the subject's case, effective age is estimated to be the same as actual age – accrued deferred maintenance must also be considered. There is observable functional obsolescence in the form of dated interior decor, older building materials, and insulation factor which is less than found in newer buildings. Market analysis and a visual observation of the subject's area indicates no external obsolescence exists. (Jette report, pg. 25)

Mr. MacDonald testified that the appraisal performed by Bob White was based on assumptions that have not been achieved. A portion of the appraisal states the following:

The projections of income and expenses herein contained were based on data provided by the management company and data obtained from other apartment complexes in and around the Helena area. They are believed to be accurate, based on the best data available at the time this report was written. However, since projections are based on assumptions about circumstances and events that have not yet taken place, they are subject to variations that may arise as future operations actually occur. Accordingly, your appraiser cannot give assurance that the projected results will actually be obtained. Also, it should be understood that the underlying assumptions are based on present circumstances and information currently available. Because circumstances may change and unanticipated events may occur subsequent to the date of this report, the reader must evaluate the assumptions and rationale in light of the circumstances then prevailing. (emphasis supplied) (White appraisal – Assumptions and Limiting Conditions, page 3)

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	White	Jette
-----------	-----	-------	-------

Date of Value	1/1/96	8/1/97	1/12/00
Land Value	\$59,200	\$122,400	\$140,000
Personal Property Value	\$14,370	\$41,250	\$14,688
Market Value – Cost Approach	\$1,484,000	\$1,453,600	\$1,040,000
Market Value – Income Approach	\$1,349,100	\$1,396,500	\$1,078,000
Market Value – Sales Comparison Approach	NA	\$1,400,000	\$1,025,000
Final Determination	\$1,349,100	\$1,400,000	\$1,078,000

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 White appraisal, exhibit H, and relied heavily on the final value conclusion in support of its value determination. While the White appraised value supports the DOR's value, the DOR must present credible evidence to show support for its 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 income 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 added.)

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 S was created, and that information was also used to create the income model (exhibit K) for neighborhood #215.

Exhibit S contains income and expense data from seventy rental properties. Of the seventy properties, thirty are duplexes, twenty-two are triplexes, and nine are fourplexes. The largest of the properties on exhibit S is a property consisting of twelve one-bedroom apartments.

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 nine rental properties (exhibit S), the two fee appraisals (exhibits H & I), and the subject property (exhibit K):

Data	Survey - Exhibit S	Subject - Exhibit K	White - Exhibit H	Jette - Exhibit I
# of rental units	NA	51	50	50
Monthly rent - 1 bedroom	\$200 - \$360 (average - \$292)	\$300	\$350	\$400
Monthly rent - 2 bedroom	\$310 - \$420 (average - \$340)	\$375	\$450	\$466
Monthly rent - 3 bedroom	\$400	\$430	\$550	\$590
Vacancy/collection loss %	0 - 30%	10%	5%	6%
Management (% of Effective Gross Income - EGI)	2% - 12%	None applied	5%	Unknown
Total expenses (% of EGI)			Actual	Stabilized

Data	Survey - Exhibit S	Subject – Exhibit K	White – Exhibit H	Jette – Exhibit I
includes management expense)	25% - 70%	24%	55%	45%
Net Operating Income (NOI) (% of EGI)	75% - 30%	75%	45%	55%
Capitalization Rate	12% - 14%	11.1%	10%	13%

It is the Board's opinion that the DOR's income model has been developed recognizing property not deemed comparable, (ARM 42-20-104 COMPARABLE PROPERTY). In addition, the DOR income approach was based on 51 rental units, when there are actually 50. Taxpayer's exhibits #5 - #9 suggest an expense ratio in the range of 37% to 52%. The DOR used an expense ratio of 24%.

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.

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.

The Board questioned the DOR with respect to exhibit F, "*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." 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 exhibit S, the questionnaires completed and returned by commercial property owners were involved with a HUD controlled 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	\$219,300	\$332,064
Financing benefit	\$0	\$46,504
Retail / Laundry & vending income	\$0	\$4,787
Percent occupancy	90%	100%
Income after occupancy	\$197,370	\$383,355
Effective gross income	\$197,370	\$383,355
Expenses	\$47,623	\$128,604
Management	\$0	\$26,835 (7% of EGI)
Total expenses	\$47,623	\$155,438
Net income	\$149,747	\$227,917
Income Capitalization		
Equity ratio	.111	.09
Effective tax rate	0	.0215
Total capitalization	.111	.1115
Value, income approach	\$149,747/.111 = \$1,349,100	\$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 letter of transmittal in the White appraisal states in summary:

I have appraised the property as a whole, owned in fee simple and unencumbered. I assume no responsibility for matters that are legal in nature not do I render any opinion as to title.

The Tower Hill Apartments and U.S. Department of Housing and Urban Development are currently entered in a contract for Section 8 Housing Assistance payments. This contract expires on September 30, 1997. It is not known if the contract will be renewed after the expiration date. Therefore, market rents/data has been used in this report to estimate current market value.

Based on the above paragraph, the property was not appraised subject to the government's Section 8 program.

Both the White and Jette 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.

On Page 22 of the Jette appraisal, under "Real Estate Taxes", states the following:

The appraisal office in Helena has valued the subject property at a site value of \$49,728, structural improvements of \$898,507, and personal property of \$16,216 for a total value of \$964,451. Although market value estimated here is less than the value estimated in this report, this is typical. The above values are dated and based primarily on replacement costs less depreciation. For this reason, they may or may not reflect accurate market values.

Mr. Jette stated in his report (page 22) *"The appraisal office in Helena has valued the subject property at a site value of \$49,728, structural improvements of \$898,507, and personal property of \$16,216 for a total value of \$964,451. Although market value estimate here is less than the value estimated in this report, this is typical. The above values are dated and based primarily on replacement costs less depreciation. For this reason, they may or may not reflect accurate market values."* It is unclear to the Board where the above information was derived and nowhere in the report is it substantiated. The DOR's value indication is actually a result of the income approach and exceeds the value arrived at in the Jette report. If the value were less, one would wonder why the appraisal would have been submitted as an exhibit. Mr. Jette's stated DOR values may be a result of MCA **§15-6-201, Exempt categories**. This legislation was passed in 1999, therefore, not in effect at the time the appeal was originally filed. In fact, this

statement is not accurate. The land value in the report exceeds the DOR's value, but the improvement value is less than the DOR's value determination and the total value is less than the DOR's. MCA **§15-7-111 MCA Periodic revaluation of certain taxable property.** *...The revaluation of class, three, four, and ten property is complete on December 31, 1996.* The DOR testified that the market value for the subject is "as of" January 1, 1996. Mr. Jette's value is "as of" January 12, 2000. The DOR is mandated by statute and administrative rule as to the date of value. Nowhere in the Jette report is the time between the two appraisals discussed. The proper procedure for Mr. Jette would have been to utilize market data prior to 1997, enabling the appraiser to capture the value as of that date.

The Jette appraisal has included the property taxes as an operating expense in the income approach to value. When a property owner disputes the DOR's value determination and an appraisal is prepared for the purposes of challenging that value, it is inappropriate to include real estate taxes as an operating expense, when those taxes are calculated based on the DOR's value determination. Property Assessment Valuation, second edition, IAAO, page 240, (herein after IAAO) *...When the income approach is used to determine the property value for tax purposes, the practice of using property taxes as an expense item is based on a preconceived value and discredits the whole approach. Because*

taxes are often the largest single expense, this practice leaves the final value conclusion subject to considerable error. The problem can be resolved by developing an effective tax rate and by including the rate in the capitalization rate for the property being appraised..." The proper method would be to include the real estate tax component, or the effective tax rate in the capitalization rate. IAAO, page 239, "The effective tax rate is the third component of the total capitalization rate. The effective tax rate is computed by multiplying the level of assessment for the property by the local current tax rate, both of which must be stated in proper decimal form..." In the case of the subject property, the taxable percentage for class four property in 1997 is 3.838% and the 1997 mill levy is 494.84. The effective tax rate would be calculated as follows under this method:

1997 taxable percentage	.03838
1997 mill levy	X .49484
Effective tax rate	<u>.01899</u>

The subject property's tax bill also includes the taxes for the furniture and fixtures of \$498 that are not under appeal. In addition, the tax bill also includes other charges in the amount of \$1,575, i.e., street maintenance, storm water, lighting district, etc., that are not necessarily calculated based on the value of the land and improvements. Therefore, the entire tax bill should not be disregarded when developing an income model for valuing a commercial property.

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. 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 post-hearing submission, the 1997 tax statement, indicates that the market value of the personal property is \$14,370.

The taxpayer presented sales of multifamily project (exhibits #5-#9) that illustrate the following.

Property	Subject	Sale #1	Sale #2	Sale #3	Sale #4	Sale #5
Exhibit #	K	#5	#6	#7	#8	#9
Location	Helena	Missoula	Billings	Billings	Billings	Great Falls
Sale Date	NA	4/29/94	7/15/94	8/11/94	9/16/96	3/11/97
Sale Price	NA	\$1,315,000	\$750,000	\$2,500,000	\$849,000	\$1,250,000
Number of Units	51	50	36	80	30	31
Year Built	1977	1972	1977	1977	1976	1977
Effective Gross Income	\$197,370	\$226,500	\$161,513	\$475,300	\$150,300	-
Operating Expenses	\$47,623	\$ 84,214	\$ 83,483	\$198,500	\$ 61,340	-
Net Operating Income	\$149,747	\$140,036	\$ 78,030	\$276,800	\$ 88,960	\$139,273
Gross Income Multiplier	NA	5.8	4.6	5.2	5.6	-
Overall Rate (OAR)	NA	10.6%	10.4%	11.1%	10.5%	11.1%
Expense Ratio (% of Effective Gross Income)						
Price Per Apartment	NA	\$26,300	\$20,833	\$31,250	\$28,300	\$40,323

The taxpayer' 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 as valorem tax purposes will be based on the cost 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 item 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 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.

The DOR was provided actual income and operating expenses for the subject property. There is nothing in the record to suggest the DOR gave any consideration or compared this information to the income model that was used to value the property.

As previously mentioned, the DOR presented two fee appraisals (exhibits H & I) conducted on the subject property and gave considerable weight to the White appraisal. (exhibit H). The DOR is mandated to reappraise property statewide and should provide supporting documentation for their value determination.

In the course of the hearings, PT-1997-164 (Tower Hill Apartments), PT-1997-165 (Helena Manor Apartments) and PT-1997-166 (Almanor Apartments), the Board determined that 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:

15 one bedroom units @ \$375.00	\$ 5,625
30 two bedroom units @ \$400.00	\$ 12,000
5 three bedroom units @ \$450.00	\$ 2,250
Total monthly apartment income	\$ 19,875
12 months	X 12
Potential Gross (apartment) Income	\$238,500
Less: Vacancy/Collection Loss (6%)	\$ 14,310
Effective Gross (apartment) Income	\$224,190
Other Income	\$ 7,500
Effective Gross Income	\$231,690
Less: Expenses (46% of EGI)	\$106,577
Net Operating Income	\$125,113
NOI Capitalized @ 11.0%	
\$125,113/11.0%	\$1,137,387

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 added.)

The market value of the subject on a price per unit basis is \$22,748 (\$1,137,387/50). Age, condition, amenities, location and unit mix are a few items that may suggest a higher or lower value

per unit value. Taxpayer's exhibit #5-#9 illustrate 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

The Jette appraisal offers an opinion of value approximately four years after the DOR was mandated to appraise the property. The taxpayer's requested value is from the previous appraisal cycle; therefore, that value was based on dated information. The White appraisal supports the DOR's value determination, but as previously noted, the value conclusion was based on assumptions never attained.

It is the opinion of the Board, that the market value of \$1,137,387, or \$22,748 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.

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

//

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 value of \$1,137,387 (Land - \$57,336; Improvements - \$1,080,051).

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:

Joseph B Reber & Sons Partnership
c/o Greg MacDonald
2929 3rd Avenue North, Suite 538
Billings, Montana 59101

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