

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

SOUTHGATE APARTMENTS, LLC,)	DOCKET NO.: PT-2009-15
)	
Appellant,)	
)	
-vs-)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
)	ORDER and OPPORTUNITY
THE DEPARTMENT OF REVENUE)	<u>FOR JUDICIAL REVIEW</u>
OF THE STATE OF MONTANA,)	
)	
Respondent.)	

Statement of Case

The above-entitled appeal was heard on March 10, 2010, in Helena, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (Board). The notice of the hearing was duly given as required by law. Southgate Apartments, LLC, represented by Richard L. Dill (taxpayer), appealed a decision of the Missoula County Tax Appeal Board (CTAB) relating to the Department of Revenue's (DOR) valuation of the property identified as 2101 Garfield Street, Section 29, Township 13N, Range 19W, Block 006, Lot 017 of Butte Addition, a major subdivision of the City of Missoula, Missoula County, State of Montana. The Taxpayer argues the DOR overvalued the property for tax purposes and seeks a reduction in value assigned by the CTAB. At the hearing, the Taxpayer provided testimony and evidence in support of the appeal. The DOR, represented by Michele Crepeau, Tax Counsel; Wes Redden, Area Manager; Jim Wilcox, appraiser; and Ross Halvorson, Management Analyst, presented testimony and evidence in opposition to the appeal.

The Board having fully considered the testimony, exhibits, and all matters presented, finds and concludes the following:

Issue

The issue before this Board is did the CTAB determine an appropriate market value for the subject property for tax year 2009?

Summary

The Taxpayer in this proceeding has the burden of proof. Based on a preponderance of the evidence, the Board modifies the decision of the Missoula County Tax Appeal Board.

Findings of Fact

1. Due, proper and sufficient notice was given of this matter and of the time and place of the hearing. All parties were afforded opportunity to present evidence, verbal and documentary.
2. The subject property is described as 2101 Garfield Street, Section 29, Township 13N, Range 19W, Block 006, Lot 017 of Butte Addition, City of Missoula, Missoula County, State of Montana. (Exh. A, 1).
3. For tax year 2009, the DOR appraised the property at a value of \$1,529,026(a land value of \$249,426 and improvements valued at \$1,279,600). (Exh. A, 2). The Taxpayer is asking for a property value of \$1,123,400. (Appeal Form).

The Taxpayer filed an appeal with the Missoula CTAB on October 4, 2009. The Missoula CTAB heard the appeal on November 23, 2009, and issued its decision modifying the DOR value to \$1,393,456 on January 11, 2010.

4. The Taxpayer appealed to this Board on February 7, 2010 and a hearing was held.

5. The Taxpayer argues the proper valuation for the building is \$1,123,400, which is approximately \$200,000 less than the value set by the Missoula County Tax Appeal Board.
6. At the hearing before this Board, the evidence and testimony showed that the Department reviewed cost, income and market approaches to value the subject property.
7. The DOR used the cost approach to value the subject property as of July 1, 2008 appraisal date. (Exh. A, 2).
8. The cost approach, \$1,529,026, was significantly higher than the income approach (\$1,392,600) calculated by the Department and the value set by the Missoula County Tax Appeal Board (\$1,393,456). (Exh. A and Missoula CTAB decision dated Jan. 11, 2010)
9. DOR appraiser, Jim Wilcox, testified he used his appraisal judgment to determine the higher value set by the cost approach more accurately reflected market value. He felt the cost approach was more appropriate than the lower value set by the income method.
10. On the property record card for the subject property, the cost approach set the value at \$1,529,026. The appraiser for the Department stated he used the higher cost approach because the apartments themselves were larger than typical apartments in Missoula. (Wilcox, Test.)
11. The cost approach to value is determined by calculating the value of the materials used, and the grade of the building construction to calculate a replacement cost less depreciation. (Halverson, Wilcox, Test.) For an older building, those determinations of quality and grade are judgments made by an appraiser.
12. In this instance, the appraiser set the effective age of the building to 1990. The building was built in 1978, and other than testimony in the county

hearing transcript about a new roof in 2007, there is no indication of major remodel or upgrades. (CTAB transcript.) Wilcox testified that the building was very well-kept.

13. Wilcox testified that the effective age was a judgment call. Wilcox also testified he has not entered any of the buildings but only performed an exterior review of the property.
14. Wilcox also set the grade of the building as “good.”
15. The Taxpayer testified the property was shoddily built and that the floor joists had to be jacked up. (Dill Test. , CTAB trans. P. 16) Dill testified at the county tax appeal board hearing that the building was average or below average. Dill also noted he has maintained and improved the property during the time he has owned it.
16. The property record card also indicated a \$1,392,600 value derived by the income approach. The income approach to valuation is calculated by analyzing the net operating income and expenses, and multiplying that value by a capitalization rate set by the Department for the region. (Exh. A, Wilcox Test.)
17. The income approach to value is the preferred method for valuing income property, and uses income and a capitalization rate to determine value. (42.20.107, ARM, Wilcox, Dill, Test.)
18. The information used in calculating the income approach is standard data used to value residential apartment complexes in Missoula, and other urban areas. (Halvorson, Wilcox, Test.)
19. The net operating income is derived by surveying property owners in the Missoula area to determine market rents, vacancy rates, and expenses. CITE. The department uses a 6% vacancy rate and a 29% expense cost. (Taxpayer A, 5.)

20. The DOR uses a survey of property owners to collect rental and vacancy rates specifically for the Missoula area. The capitalization rate is calculated on a state-wide basis for all urban areas. (Halvorson, Test.)
21. Only 10% of the property owners complete the survey on income and expenses of rental property. (Halvorson Test.)
22. The monthly rent used by the Department of Revenue to calculate the income approach is greater than the actual rents collected by the Taxpayer. The Department did not calculate the covered parking into the income approach in this instance. (Exh. A, 5.)
23. The Taxpayer admitted in testimony that he charged less than market rents for his units. (Dill, Test.) He also testified that his vacancy rate is lower than the average vacancy rate.
24. Dill testified he believed the income approach to value was proper but he believed the DOR capitalization rate was too high.
25. During hearing, the DOR stated they were not appealing the CTAB's adjusted value for the subject property. They believed the value of \$1,393,456 to be appropriate and closely matched the income approach. (DOR closing statement, Ms. Crepeau).
26. Mr. Dill argued he did not believe the appeal process was fair to the taxpayer and also testified he did not receive the last page of the property record card (with the income approach information) during discussions with the Department. (Dill, Test.)

Principles of Law

1. The State Tax Appeal Board has jurisdiction over this matter. (Section 15-2-301, MCA).
2. All taxable property must be assessed at 100% of its market value except as otherwise provided. (Section 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. (Section 15-8-111(2)(a), MCA).
4. When determining the market value of commercial properties, department appraisers will consider, if the necessary information is available, an income approach valuation. If the department is not able to develop an income model with a valid capitalization rate based on the stratified direct market analysis, the band-of-investment method, or another accepted method, or is not able to 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. (42.20.107, ARM).
5. 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. (42.20.108(1), ARM).
6. The department periodically requests gross rental income and expense information from commercial property owners. Standard forms, developed by the department, are used to collect the information statewide. Additional methods of obtaining income and expenses information may consist of personal or telephone contacts with owners, tenants, renters or lessees, knowledgeable lending institution officials, real estate brokers, fee appraisers, or any other sources the appraiser deems appropriate including summarized data from recognized firms which collect income and expense information, and appeal or court actions. (42.20.108(3), ARM).

7. When using the income approach, the department will develop overall capitalization rates which may be according to use type, location, and age of improvements. (42.20.109(1), ARM).
8. A straight-line recapture rate and effective tax rate will be added to the discount rate to determine the yield capitalization rate. (42.20.109(3), ARM).

Board Discussion and Conclusions of Law

The Board must determine, based on a preponderance of the evidence, whether the CTAB set an appropriate valuation for the subject property for tax year 2009.

As a general rule, the appraisal of the Department of Revenue is presumed to be correct and the Taxpayer must overcome this presumption. The DOR uses mass appraisal techniques to appraise nearly one million properties statewide. Generally, the DOR completes this task with a high percentage of accuracy, although errors certainly do occur. Thus it is proper that the Department of Revenue should 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).

The Department may use different approaches (for example, market, income, and/or cost approaches), depending on available data, to appraise a property. *See, e.g., Albright v. Montana Department of Revenue*, 281 Mont. 196, 933 P.2d 815, (1997). In this instance, even though the DOR completed all three approaches to value, the Department relied solely on the cost approach to value the subject property. *FOF 7*. To be reliable, this approach requires

several accurate determinations of value, such as the quality of the building materials, the level of maintenance, and other information. Such determination requires detailed on-site inspection or other knowledge of the building and the materials. It also requires a separate appraisal of the land which can be difficult when no comparable sales of buildable land in that vicinity have occurred.

When determining the market value of commercial property during a mass appraisal, it is, therefore, most appropriate for the DOR appraisers to first consider an income approach which requires neither an inspection nor a separate land valuation process. There is no question that the income method to determine value is the method used by purchasers of income property. This is also the approach favored by rule (ARM 42.20.107) and supported by Montana Courts. *See Meridian Pointe v. Montana Department of Revenue*, 1997 Mont. Dist. LEXIS 118. Because the income approach to value is the most common valuation method used by investors and the market, utilizing a higher cost approach valuation will not generate a true market value, but will likely overvalue a particular property.

This case is no exception. The evidence presented by the DOR supported the market value established by the income approach. Unfortunately, the appraiser chose to use the less reliable cost approach. The evidence does not support using a cost approach that derived a higher market value. Not only is there insufficient evidence that the income approach does not properly value the subject property, the appraiser failed to make an on-site inspection that would justify the higher value. *See* FOF 13. The reason given at hearing for the use of a cost method was that the apartments were larger than the usual Missoula apartments, as they have three bedrooms rather than two, had covered parking, and the appraiser felt they were therefore of higher quality

than typical rentals (Wilcox Test.) However, the DOR has average rent data for 3 bedroom 1 bathroom apartments for the Missoula area (FOF 20, Wilcox Test.)

The Taxpayer claimed the capitalization rate used by the DOR was unrealistically low and suggested that an 8% CAP rate more closely reflects real world rates. He also contended the other methods of appraisal were riddled with calculation errors and the documentation initially provided to him by the DOR was incomplete. This Board disagrees. The DOR collects surveys, prior to the appraisal date, from commercial property owners in an effort to set a reliable CAP rate for rural and urban areas of Montana. Even though only 10% of the property owners complete the survey, the survey still produces a large amount of data, which the DOR confirms through third party sources, to produce an accurate outcome. (FOF 20 and 21.)

Out of necessity, Montana uses a mass appraisal approach to provide uniformity and consistency to ad valorem taxation. Without this approach it would be impossible to produce timely, accurate or equitable values across the state without a significant cost increase to the DOR.

At the conclusion of the CTAB hearing the Board adjusted the value of the subject property to \$1,393,456¹; very close to the DOR's income approach value. While we disagree with the CTAB reasoning, the value closely mirrors the income approach in this case.

It is the opinion of this Board that the value set by the decision of the Missoula County Tax Appeal Board be modified to reflect the income approach value.

¹ The Missoula County Tax Appeal Board adjusted the land value of the subject property, but no evidence of a land value decline was presented at the county or state level. (Missoula CTAB decision, CTAB trans.)

Order

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property value shall be entered on the tax rolls of Missoula County at a 2009 tax year value of \$1,392,600 as determined by the income approach completed by the Department of Revenue. The decision of the Missoula County Tax Appeal Board is modified.

Dated this 25th of March, 2010.

BY ORDER OF THE
STATE TAX APPEAL BOARD

/s/ _____
KAREN E. POWELL, Chairwoman

/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 March, 2010, 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:

Southgate Apartment, LLC	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid
20835 Old US Highway 93	<input type="checkbox"/> Hand Delivered
Missoula, Montana 59833	<input type="checkbox"/> E-mail

Wes Redden	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid
Ross Halverson	<input type="checkbox"/> Hand Delivered
Missoula County Appraiser Office	<input type="checkbox"/> E-mail
2681 Palmer St., Ste. I	<input type="checkbox"/> Interoffice
Missoula, MT. 59808	

Michelle R. Crepeau	<input type="checkbox"/> U.S. Mail, Postage Prepaid
Office of Legal Affairs	<input type="checkbox"/> Hand Delivered
Department of Revenue	<input type="checkbox"/> E-mail
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Dale Jackson, Chairman	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid
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