BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

WELLS FARGO SERVICE COMPANY,	)	DOCKET NO.: PT-2003-126
	)	
Appellant,	)	
	)	
-vs-	)	FACTUAL BACKGROUND,
	)	CONCLUSIONS OF LAW
THE DEPARTMENT OF REVENUE	)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,	)	FOR JUDICIAL REVIEW
	)	
Respondent.	)	

The above-entitled appeal was heard on October 28, 2004, in Billings, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (Board). The notice of the hearing was given as required by law. The appellant was represented by John T. Jones, attorney; Dan Majeske, Regional Property Manager; and David C. Thomas, appraiser (Taxpayer). The Taxpayer presented evidence and testimony in support of the appeal. Appraisers Vicki Nelson and Ross Halvorson represented the Department of Revenue (DOR). DOR presented evidence and testimony in opposition to the appeal. The appeal involves the valuation of the Wells Fargo Operations Center located in Yellowstone County.

The duty of this Board is to determine the appropriate market value for the property based on a preponderance of the evidence. Testimony was taken from both the Taxpayer and the Department of Revenue, and exhibits from both parties were received. The Board allowed the record to remain open for a period of time for the purpose of receiving post-hearing submissions from both parties.

The Board issued an Order in this matter on February 28, 2005. That decision was vacated on March 16, 2005, to allow the Taxpayer thirty days to reply to the DOR's post-hearing comments on Exhibit 3. The Board received the Taxpayer's Reply to DOR's Post-Hearing Submittals on April 20, 2005.

Based on the evidence and testimony, the Board upholds the decision of the Yellowstone County Tax Appeal Board.

FACTUAL BACKGROUND

1. Due, proper, and sufficient notice was given of this matter, of 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 commercial in character and is described as follows:

   > Lots 1A, 2, 3A, 4 and 4A-1 of Block 1 of the Hogan Homestead Subdivision, Second Addition HGM, at 2324 Overland Drive, City of Billings, County of Yellowstone, State of Montana. (Geocode #: 03-0927-18-2-01-01-0000)

3. The DOR's original 2003 value was $1,560,021 for the land and $22,816,800 for the improvements (Appeal Form).

4. The taxpayer filed an AB-26 property review form, but the DOR made no adjustments based on this informal review saying, "Data appears to be accurate. Cost approach to value was utilized." (DOR Exhibit F)

5. The taxpayer filed an appeal with the Yellowstone County Tax Appeal Board (County Board) on August 13, 2003, requesting an improvement value of $13,409,793, citing the following reasons for appeal:

> The subject property is valued in excess of fair market value based on the three approaches to value; income, market, and cost approaches. The primary difference is related to calculation of depreciation as supported by the income and sales comparison approaches to value.

6. In its May 5, 2004 decision, the county board adjusted the valuation, stating:

> The Department of Revenue was willing to make an adjustment by submittal of requested information that has not yet been done. From Testimony presented this Board feels an adjustment is due & therefore, adjusts the value of the subject property to $19,500,00.00.

7. The taxpayer appealed that decision to this Board on June 4, 2004 stating:

> The subject property is valued in excess of fair market value based on three approaches to value: income, market, and cost approaches. The primary

difference is related to calculation of depreciation as supported by the income and sales comparison approaches to value. The total appraised value set by the Montana Department of Revenue is $24,376,821.00. The appraised value as determined by the Yellowstone County Tax Appeal Board based on testimony is $19,5000,000.00. The appraised value as determined by the taxpayer is $14,969,814.00.

8. The Board issued its original decision in this matter on February 28, 2005. On March 15, 2005, the Board received Taxpayer's Motion to Vacate the original decision to give the Taxpayer an opportunity to receive and comment on DOR's post-hearing submission. On March 16, 2005, the Board vacated its original decision and granted the Taxpayer a 30-day period to submit a rebuttal to the DOR post-hearing submission. The Taxpayer's Reply was received at the Board on April 20, 2005.

TAXPAYER'S CONTENTIONS

The Taxpayer asserts that an accurate valuation of the subject property requires the use of all three approaches to valuation – cost, sales comparison, and income. The Taxpayer also points out that the income approach is the preferred approach to valuing commercial property and objects to DOR's decision to base their valuation of this property solely on the cost approach.

Taxpayer's Exhibit 3 is an independent fee appraisal prepared by David C. Thomas, a Montana Certified General

Appraiser and President of Thomas Appraisal Services, Inc. Exhibit 3 estimates the market value of the subject property to be $12,000,000. The Taxpayer presented this information de novo and asked the Board to consider the valuation of $12,000,000 as the total value for the property over the value indicated by the Taxpayer on the appeal form. Exhibit 3 estimates the value of the subject property as of September 27, 2004 and includes in the valuation a 12,000 square foot addition built in 2003.

Exhibit 3 incorporates all three approaches to estimating value. In the cost approach, the basis used to value the subject land is a market analysis of recent comparable sales of vacant land and the basis used to value the improvements is updated costs provided by the operations center's building contractor. Exhibit 3 identifies very little physical depreciation but extensive functional and external obsolescence due to redundancy in all the mechanical and electrical systems in the building. These redundancies are considered superadequacies.

The appraisal combines the categories of functional and external obsolescence and, using a feasibility analysis, estimates this overall "economic" depreciation at $4,987,401. (Exhibit 3, page 17). Exhibit 3's final value estimate using the cost approach is a total value (land and improvements) of $14,910,000. (Exhibit 3, page 17).

For the sales comparison approach, Exhibit 3 uses six office building sales in Billings, two out-of-state sales and one out-of-state listing. (Exhibit 3, page 22). Exhibit 3 notes that the Billings sales are not truly comparable to the operations center but do provide an indication of the Billings market. (Exhibit 3, page 22.) The three out-of-state properties were then used as support for the final value developed through this approach. This information was further supplemented through conversations with real estate brokers in- and out-of-state. Based on an analysis of this information, Exhibit 3 estimates the value of the subject property to be $12,010,000 using the sales comparison approach. (Exhibit 3, page 25).

Market rent used in the income approach in Exhibit 3 is based on a rental survey of eight professional office buildings in the Billings market. Because the appraisal found that “none of the . . . eight properties are truly comparable to the subject”, discussions were held with several Billings real estate brokers on possible rental rates for the subject property. (Exhibit 3, page 28). Based on this information and on the very large size and open office area configuration of the subject, Exhibit 3 "estimated a market rental rate for the subject property to be $8.50 per square foot on a net basis". (Page 29). After deducting a vacancy allowance and expenses, the net operating income was divided by a capitalization rate drawn from the sales analyzed in the sales comparison approach. The estimated value arrived at through the income approach totaled $11,160,000. (Exhibit 3, page 31).

In summary, the values indicated by each of the three approaches in Exhibit 3 (page 33) are:

COST APPROACH	**$14,910,000**
SALES COMPARISON APPROACH	**$12,010,000**
INCOME APPROACH	**$11,160,000**

Exhibit 3's final estimate of market value for the subject property is $12,000,000. (Page 33).

The Taxpayer notes that DOR did not consider valuations derived from all three approaches and instead relied solely on the cost approach. The Taxpayer stresses that the cost approach is the least reliable approach to use in valuing this property. The Taxpayer objects to DOR's decision not to apply functional and external obsolescence to the property even though DOR chose to use the cost approach to determine the market value of this property. The Taxpayer points out that, when the department uses construction cost as one approximation of market value, state law requires them to "fully consider a reduction in value caused by depreciation, whether through physical depreciation, functional obsolescence, or economic obsolescence". [15-8-111(2)(b) Montana Code Annotated]. According to the Taxpayer, DOR failed to do so in this case.

The Taxpayer asserts that this property is overbuilt for the Billings market and the typical user of office space will not pay for the redundancy in the mechanical and electrical systems. Thus, the value of this property is substantially reduced as a result of the functional/external obsolescence and that reduction in value must be reflected in the property's assessment.

DOR CONTENTIONS

DOR Exhibit A is the Property Record Card for the subject property on the assessment date of January 1, 2002. It presents the valuation DOR is defending which is based on a gross building area of 165,226 square feet. DOR will not assess the 12,000 square foot addition included in the valuations in Exhibit 3 until 2004.

DOR Exhibit I displays the information from the Property Record Card in a spreadsheet format. This Exhibit also shows the adjustments DOR made (summarized below) after the County Board lowered the valuation to $19,500,000.

	Value	Adjusted Value
Land	$1,560,021	$1,560,021
Improvements:		
1st Floor	$14,657,198	$14,657,198
Total Building Other Features:	5,536,030	1,117,966
Total RCNLD – First Floor & BOF	$22,276,265	$17,402,455
Other Building and Yard Imps	540,560	540,560
Total First Floor, BOF and OBY	$22,816,825	$17,943,015
Total Property Value -Land & Improvements	**$24,276,846**	**$19,503,036**

Value adjusted by CTAB - $19,500,000

The decrease in the Adjusted Value for "Total Building Other Features" results from reductions DOR made in the valuation of the computer floor and of the fire suppression system in the computer room. These adjustments are based on DOR Exhibit G, bid documents provided by the building contractor. With these changes, the DOR's total adjusted value comes to $19,503,036, very close to the $19,500,00 value set by the County Board. Thus, DOR did not cross-appeal the County Board's decision.

The DOR valuation for the subject property is derived solely through the cost approach. The Department points out that the cost approach is used most appropriately when a building is new, as the subject property is. DOR does not consider the redundant mechanical and electrical systems to be a superadequacy. In post-hearing comments on Exhibit 3 submitted December 6, 2004, the Department states:

> IAAO defines super-adequacy as a condition in which the component is more than adequate for its intended function. The highest and best use, stated [in Exhibit 3], as an improved property is [the subject's] current use.
>
> > *Page 12 [Exhibit 3]: In short, the building was specifically designed for a single user as an operations center and the building functions very well for that specific use. Therefore, the highest and best use of the property 'as improved' is its present use as an operations center for Wells Fargo Bank.*
>
> Wells Fargo constructed this building to suit the specific needs of their operations. It serves as a clearinghouse for a fourteen state area. It is not unreasonable to assume that safety precautions, such as back up systems, would be included in the construction process to insure that business would continue as normal in the event of a power failure. . . . Therefore, the excess mechanical and electrical systems, are not super-adequate for the intended function of Wells Fargo operations center . . .

Accordingly, DOR did not reduce its assessment for functional obsolescence from the redundant mechanical and electrical systems.

DOR did consider using the income approach in valuing this property. DOR Exhibit O is a copy of the Income Model developed to value office buildings in certain neighborhoods of Yellowstone County, including the area in which the subject property is located. The model covers income and expense information from seventy-seven property owners in these neighborhoods. DOR Exhibit P is the DOR's capitalization rate calculations based on nineteen sales in the Billings market. In analyzing this information, DOR found that the properties they used in the Income Model (Exhibit O) and the sales used in the capitalization rate calculations (Exhibit P) were not sufficiently comparable to the operations center to be adequate in valuing this property. Consequently, the Department did not use the income approach for this property.

DOR post-hearing comments on Exhibit 3 point out that the Taxpayer often states the difficulty of finding properties that could be considered comparable to the operations center. DOR further points out that, because the building is owner-occupied, there is "no actual rental data available for the subject property." DOR maintains, however, that:

> [T]here is market evidence [in Exhibit 3] that the Billings market will support rent in excess of $12.00 per square foot on properties that are newer in age, exhibit a higher quality of construction, offer amenities not found in the typical office building and are situated in a desirable location.

DOR asserts that the subject property meets all these criteria, but that the Taxpayer chose to ignore this market data.

DOR believes the market values developed through the sales and income approaches in Exhibit 3 are inaccurate and unreliable, given the problems the DOR highlights in its post-hearing comments on Exhibit 3. Because there are not comparable properties to use in a sales comparison or an income approach and because the cost approach used by DOR is in line with the actual building costs of this property, DOR asks the Board to uphold the decision of the County Board and value the property at $19,500,000.

TAXPAYER'S REPLY TO DOR'S POST-HEARING SUBMITTAL

In reply to the DOR's post-hearing comments on Exhibit 3, the Taxpayer emphasizes the Department's responsibility to assess the subject property at 100% of its fair market value, as defined in §15-8-111(2)(a) MCA. The Taxpayer further emphasizes the Department's obligation to fully consider the effect of functional and economic obsolescence on the value of this property, as required by §15-8-111(2)(b) MCA, when the Department uses the cost approach to value. The Taxpayer maintains that the DOR "did not comply with this statutory mandate." (Taxpayer's Reply Exhibit 1).

The Taxpayer asserts that the definition of superadequacy used by the DOR is misleading in regard to the subject property. The Taxpayer cites instead the definition given in the Appraisal of Real Estate, 12th Edition: "A superadequacy is a type of functional obsolescence caused by something in the subject property that **exceeds market requirements but does not contribute to value an amount equal to its cost.**" (Page 404, emphasis added by Taxpayer). The Taxpayer repeats that superadequacy is the issue at the heart of their disagreement with DOR over the value of the subject property.

The Taxpayer repeatedly states that the sheer size of the subject property constitutes a superadequacy. According to the Taxpayer, the absence of comparable properties, even within a five-state region, further supports their position that the subject is overbuilt for what the market demands and is therefore superadequate. In addition, the Taxpayer disputes the applicability of the DOR's statement that "the Billings market will support rent in excess of $12.00 per square foot" on certain properties. (DOR post-hearing comments on Exhibit 3). The Taxpayer notes that "There is plenty of market evidence suggesting rental rates decline as a space gets larger, . . ." (Taxpayer's Reply Exhibit 1) and points out that the largest space identified as renting in the $12.00 to $15.00 per square foot range is 11,458 square feet, not 177,000 square feet.

Finally, the Taxpayer states several times that the DOR has failed to carry its burden of proof.

BOARD DISCUSSION

The subject property is a Wells Fargo operations center. The center was built to house a servicing center that processes daily 2000 loans from 800 banks, a call center that answers up to 20,000 calls a day and an operations center with the Technology Connection division of Wells Fargo. (DOR Exhibit C, news article from Western Business News).

The DOR has assessed the subject property using only the cost approach to valuation. DOR did not reduce their valuation for the redundancies in the property's mechanical and electrical systems nor for the large size of the subject's improvements, which the Taxpayer maintains are superadequacies. In assessing this property, the Department considered the income approach but found that their income model did not include properties comparable to the subject property.

The Taxpayer maintains that the property is valued in excess of fair market value. The Taxpayer believes the cost approach is the least reliable approach for valuing this property and offers an independent fee appraisal (Exhibit 3) which values the property using the cost, sales comparison, and income approaches. Exhibit 3 also identifies $4,987,401 in functional/external obsolescence due to the superadequacies in the mechanical and electrical systems and the size of the subject’s improvements. (Page 21).

The Taxpayer and DOR both acknowledge the difficulty in locating other properties comparable to the subject property. Taxpayer’s Reply Exhibit 1 states in Part e. Conclusion by Expert Thomas:

> ***If there remains any doubt, Taxpayer once again states, none of the comparables used in the appraisal are truly comparable to the subject property.*** This is because there are no other buildings in Montana comparable to the subject, which is one reason why the building is superadequate.

However, the reliability of the sales comparison and income approaches to valuation of any property rests on the availability of data from properties reasonably comparable to the property being valued. When that data is inadequate or absent, the skill of an appraiser is not enough to overcome the deficiency in the available data to provide reliable valuations.

In <u>Albright v. State of Montana</u>, 281 Mont. 196, 202-203, 933 P.2d 815, 819 (1997), the Montana Supreme Court noted, “The widest application of the cost approach is in the appraisal of properties **where the lack of adequate market and income data preclude the reasonable application of other traditional approaches.**” (Emphasis added). In addition, the cost approach is considered most reliable when a building is new, as the subject property is. (The Appraisal of Real Estate, 11th Edition, page 338.) It is the Board's opinion that the data available for the sales comparison and income approaches in valuing the subject property is inadequate for a reasonable application of these approaches and that the cost approach is, accordingly, appropriate in this case.

The Board agrees with the Taxpayer that, when using the cost approach, the DOR is required by law to give full consideration to all forms of depreciation. DOR Exhibit I details the reductions in value attributable to physical depreciation (% Good in Exhibit I) and to market conditions (Economic Condition Factor in Exhibit I). Testimony by the Department's representative indicates that the DOR did not consider functional obsolescence in valuing this property. The Board does not condone this failure on the part of the Department. There is a clear statutory duty for the Department to consider all forms of depreciation when valuing a property through the cost approach.

For our part, the Board has carefully reviewed all of the Taxpayer's material and is not persuaded that functional and external obsolescence combined represent a loss in value of $4,987,401 as shown in Exhibit 3. To arrive at this figure, the Taxpayer used data from the income approach detailed in Exhibit

3. As noted above, to be reliable, the income approach requires data from properties reasonably comparable to the property being valued. In this case, everyone agrees that there are not available properties that are truly comparable to the subject.

The Taxpayer identifies the current use of the subject as the highest and best use of the property "as improved". (Exhibit 3, page 12). It is the Board's opinion that the current use, or any similar use dependent on information and/or communication technology, requires the mechanical and electrical system redundancies that the Taxpayer built into this property and those redundancies cannot therefore be considered superadequacies in valuing the subject property using the cost approach.

The Taxpayer is the Appellant in this proceeding and therefore has the burden of proof. It is true, as a general rule, that the appraisal of the Department of Revenue is presumed to be correct and that the Taxpayer must overcome this presumption. The Department of Revenue should, however, bear a certain burden of providing documented evidence to support its assessed values. (Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3, (1967).

This Board must evaluate the evidence that it has been presented and issue an opinion of value based upon that evidence. It is the opinion of this Board that the value set by the Yellowstone County Tax Appeal Board and agreed to by the DOR is the appropriate valuation for this property.

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. §15-6-134. Class four property -- description -- taxable percentage. (1) Class four property includes: (g) (i) commercial buildings and the parcels of land upon which they are situated;
4. Western Airlines, Inc., v. Catherine Michunovich et al., 149 Mont. 347, 428 P.2d 3 (1967).
5. Albright v. Montana Department of Revenue, 281 Mont. 196, 933 P.2d 815 (1997).
6. The appeal of the Taxpayer is hereby denied and the decision of the Yellowstone County Tax Appeal Board is upheld.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject property shall be entered on the tax rolls of Yellowstone County by the local Department of Revenue office at the value of $1,560,021 for the land and $17,939,979 for the improvements. The decision of the Yellowstone County Tax Appeal Board is upheld.

Dated this 6th day of June 2005.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

____
GREGORY A. THORNQUIST, Chairman

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JOE R. ROBERTS, 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 6th day of June, 2005, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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