

BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

IN THE MATTER OF THE EQUALIZATION
APPEAL OF USA LIONS GATE 1-22, LLC
FOR THE YEAR 2004 FROM JOHNSON
COUNTY, KANSAS

Docket No. 2004-5438-EQ

ORDER

Now the above-captioned matter comes on for consideration and decision by the Board of Tax Appeals of the State of Kansas.

Having exercised jurisdiction pursuant to K.S.A. 79-1609, the Board conducted a hearing of this matter on June 24, 2005. The County and Taxpayer each were given full opportunity to present their arguments to the Board. After considering all of the evidence and premises presented by the parties in support of their respective positions, the Board finds and concludes as follows.

I.

The subject matter of this tax equalization appeal is described as follows:

Real estate and improvements commonly known as
Lions Gate Apartments, 14631 Broadmoor Street,
Overland Park, Johnson County, Kansas, also known as
Parcel ID# 046-NP65750000-0001.

The subject property is an apartment complex built in 2000 which consists of 188 one-bedroom units, 140 two-bedroom units and 32 three-bedroom units. The complex consists of 43 two-story buildings with a clubhouse and a swimming pool. The effective date of this *ad valorem* tax valuation is January 1, 2004.

The subject property is classified as residential real property pursuant to K.S.A. 79-1439(b)(1)(A). In the appeal process the Taxpayer provided actual income and expense information to the County. For the tax year in question, the property had a 37.5 percent economic vacancy rate. (Economic vacancy is the sum of physical vacancy and rent concessions.) The information provided by the Taxpayer to the County indicated that the actual annual income from the subject property was \$2,950,366 for the year in question. The County did not use actual income and expense data in its valuation model but instead used market rental income and expense data from its mass appraisal system.

During the appraisal process the County considered four transactions involving investment "Class A" apartment complexes (as denominated by the County). Two of those transactions involved apartment complexes that are comparable to the subject

property in size, age, number of units, and location. In the first transaction, the property sold for \$73,813 per unit. In the second transaction, the property sold for \$65,361 per unit. The per-unit sale prices of all four "Class A" properties were between \$65,361 and \$103,529. The County considered the four "Class A" sales in its valuation but did not adjust the sales or perform a thorough market analysis of the properties.

The subject property sold in August 2004, approximately eight months after the effective date, for \$30 million. The owner signed a Kansas Real Estate Sales Validation Questionnaire asserting that the sale was an arms length transaction. The County testified that it independently verified the validity of the sale. The County provided no evidence of how the sale price was apportioned with respect to personal property and real property. The County also provided no analysis of how the sale should be adjusted to account for changes in conditions between the effective date of the assessment (January 2004) and the date of the sale (August 2004). For these reasons, the August 2004 sale of the subject property offers only limited evidentiary value in the present appeal.

At the hearing of this appeal the County presented one exhibit through the testimony of appraiser Stan Moulder. The parties do not dispute Mr. Moulder's qualifications to give testimony as an expert in the instant appeal. Although Mr. Moulder did not himself prepare portions of the exhibit, he did inspect the subject property prior to the hearing and testified that he was familiar with the subject property and the surrounding area. He also testified that the County used accepted appraisal practice adapted to mass appraisal to estimate the value of the subject property for purposes of *ad valorem* taxation and considered each pertinent item listed in K.S.A. 79-503a. Mr. Moulder testified that mass appraisal requires a division of tasks, and he identified the County personnel who performed the various tasks in appraising the subject property.

The County's valuation of the subject property for tax year 2004 was \$28,968,100. That valuation estimate was derived from an income analysis. The County also performed, but did not rely on, a cost analysis of the property. According to the County, the cost analysis yielded an estimated value of \$40,195,200.

The Taxpayer asserts that the correct value of the subject property for tax year 2004 is approximately \$18.7 million. The Taxpayer presented no witnesses at the hearing to support its asserted value.

With its post-hearing brief, the County moved the Board to dismiss the Taxpayer's appeal on the basis that the Taxpayer is a foreign limited partnership which forfeited its privilege to do business in the State of Kansas by failing to file an annual report. On May 15, 2006, the Board ordered that the Taxpayer respond to the County's motion to dismiss within 30 days, which it did by filing its Notice of Substitution of Parties and Request to Vacate Order on Motion to Dismiss. The County was provided ample opportunity to reply to the Taxpayer's response but failed to do so. Therefore, the Board hereby grants the Taxpayer's Notice of Substitution of Parties and Request to Vacate Order on Motion to Dismiss.

II.

The Board turns now to the merits of the instant appeal. The crux of the Taxpayer's argument is that the County's trial exhibit failed to satisfy certain requirements of the Uniform Standards of Professional Appraisal Practice (USPAP). In particular, the Taxpayer notes that the County's exhibit did not contain a USPAP Standard 6-8 certification and did not provide a "highest and best use" analysis as required by USPAP Standard 6-7. Based on these deficiencies, the Taxpayer argues it would be improper for the Board to rely on the County's exhibit as evidence to support a valuation ruling. In its briefing the Taxpayer refers liberally to the case Board of County Comm'rs v. Jensen, 32 Kan. App. 2d 730, 88 P.3d 242 (2004).

The Board concludes that Jensen is not directly applicable in the instant appeal. In Jensen, the Kansas Court of Appeals reversed the Board's order in part because the Board had adopted a valuation methodology based on an aggregated sales comparison approach, an approach expressly prohibited under USPAP. Jensen, 32 Kan. App. 2d at 735 (Under Standards Rule 1-4(e), an appraiser must "refrain from valuing the whole solely by adding together the individual values of the various estates or component parts.") In reversing the Board's final value determination, the court concluded that the Board's "reliance on an approach to value that is expressly prohibited by the USPAP was a departure from prescribed procedure and was erroneous as a matter of law." Id. at 735.

In Jensen the court recognized that Kansas law requires *ad valorem* appraisal practice be governed by uniform standards. Id. The director of property valuation is required to adopt rules and regulations or appraiser directives prescribing such standards. *See* K.S.A. 79-505. In 1992 the director of property valuation published a directive requiring county appraisers to conform to USPAP in the performance of appraisals for purposes of *ad valorem* taxation. *See* PVD Directive 92-006.

Notwithstanding the director of property valuation's duties concerning regulation of the standards and ethics governing *ad valorem* tax appraisal, this Board must fulfill its quasi-judicial function. The Board must consider all of the evidence adduced at the hearing and determine the correctness and validity of the county's valuation based on that evidence. *See generally* K.S.A. 79-1609. It is the duty of the director of property valuation to regulate and monitor the professional standards and practice of county appraisers; it is the duty of this Board to hear and weigh valuation evidence as defined by statute and in accordance with the Kansas Administrative Procedure Act (KAPA). Under KAPA, technical rules of evidence need not apply, and parties are given "reasonable opportunity to be heard and to present evidence." K.S.A. 77-524(a). *See also* Appeal of Horizon Tele-Communications, Inc., 241 Kan. 193, 734 P.2d 1168 (1987).

Based on the entire record – the written documents and the uncontroverted testimony of Mr. Moulder, a qualified appraiser – the Board concludes that the County has come forward with substantial competent evidence to allow the Board to reach a determination of value in accordance with methods recognized by USPAP and Kansas

law. The Board concludes further that any deviations from USPAP in the County's written exhibit are not materially detrimental to the overall opinion rendered by the County's expert. See In re Amoco Production Co., 33 Kan. App. 2d 329, 337, 102 P.3d 1176 (2004), *rev. denied* June 9, 2005. In particular, the lack of a Standard 6-8 certification in the County's exhibit did not substantially impact the County's overall opinion of value, in view of Mr. Moulder's testimony under oath. In regard to the exhibit's deficient "highest and best use" analysis (required under USPAP Standard 6-7), the Board finds there is no record evidence that would indicate the highest and best use of the subject property is anything other than its current use. Any shortcomings in the County's presentation go to the weight, not the admissibility, of the evidence.

III.

The Board turns now to the question of valuation. Each parcel of non-agricultural property in Kansas must be appraised at its fair market value. K.S.A. 79-501. The term fair market value is defined as that "amount in terms of money that a well informed buyer is justified in paying and a well informed seller is justified in accepting for property in an open and competitive market, assuming the parties are acting without undue compulsion." K.S.A. 79-503a.

From the outset it is important to note that in valuing property for purposes of *ad valorem* taxation, Kansas law provides that "[s]ales in and of themselves shall not be the sole criteria of fair market value but *shall be used* in connection with cost, income and other factors...." K.S.A. 79-503a (emphasis provided). Implicit in the statute is the concept that sales shall be an essential basis of appraisal practice under the Kansas *ad valorem* tax system.

In the instant appeal, the County presented summary evidence of four comparable sales but failed to analyze or adjust those sales. The Board is perplexed by this practice, considering the ready availability of comparable sales data. The subject property is identified as The Village at Lions Gate. The County provided general market information regarding two recent transactions involving properties identified as The Lakes at Lions Gate I and The Lakes at Lions Gate II. The subject property was built in 2000 and contains 360 apartment units. The Lakes at Lions Gate I and II were built in 2000 and 2001, respectively. The Lakes at Lions Gate I and II contain 360 and 356 units, respectively. The Lakes at Lions Gate I sold for \$73,813 per unit in January 2003. The Lakes at Lions Gate II sold for \$65,361 per unit in April 2003.

Despite a dearth of sales analysis presented by both parties, the sales of the two Lakes at Lions Gate properties strongly suggest that the subject property likely would have sold in the range of \$22.8 million to \$25.8 million (after allowances for personal property). The County's assigned value for the subject property is approximately \$3.1 million higher than the upper end of that range.

The sales data for the Lakes at Lions Gate I and II provide a reasonable range of values. It is, however, important to note that the ideal method of valuation would have been to adjust those sales and provide a thorough reconciliation of the market approach, the income approach and the cost approach. Neither the County nor the Taxpayer presented such an analysis. Consequently, in order to arrive at a reasonably precise determination of value for the subject property based on the available data, it is appropriate to consider the only acceptable valuation methodology for which there is adequate evidence – the income approach.

The income approach “restates market value by converting the future benefits of property ownership into an expression of present worth...” *See* International Association of Assessing Officers, Property Assessment Valuation, at 203 (2nd ed. 1996). In this approach the appraiser determines the amount of income that the subject property may be expected to yield, and the rate of return that investors in properties such as the subject would expect to receive on their investment. The appraiser then determines the maximum amount of money that an investor would be able to pay for the property and still receive the expected rate of return.

There are eight fundamental steps in applying the income approach:

1. Estimate potential gross income.
2. Deduct for vacancy and collection loss.
3. Add miscellaneous income to get the effective gross income.
4. Determine operating expenses.
5. Deduct operating expenses from the effective gross income to determine net operating income before discount, recapture, and taxes.
6. Select the proper capitalization rate.
7. Determine the appropriate capitalization procedure to be used.
8. Capitalize the net operating income into an estimated property value.

In its income analysis, the County estimated the potential gross income to be \$4,185,732 based on the following rental rates: \$0.98 per square foot for one-bedroom units, \$0.90 per square foot for two-bedroom units, and \$0.92 per square foot for three-bedroom units. Notably, the County’s own evidence establishes that the predominant rental rates for “Class A” properties are as follows: \$0.88 per square foot for one-bedroom units, \$0.80 for two-bedroom units, and \$0.80 for three-bedroom units.

The County applied a vacancy and collection rate of 10 percent and a miscellaneous income factor of 3 percent. These calculations result in an effective gross income of approximately \$3,880,174. The County's estimated net operating income was \$2,517,045 based on a \$3.65 per square foot expense factor. The County capitalized the net operating income at 8.4718 percent, which was comprised of a capitalization rate of 7.25 percent and a tax load of 1.2218 percent. The County's personal property allowance was 2.5 percent of the total appraised value.

The County's expert testified that, in order to appraise the fee simple interest in the property, the income approach required the use of market rent, market vacancy, market expenses and market capitalization. The Taxpayer offered no evidence to controvert the County's income methodology or conclusion of value.

The Board therefore adopts the County's income approach methodology, a methodology that conforms to USPAP. The Board also adopts the County's income data, with the exception of its rental rates. Instead of using unsubstantiated market rental rates at the upper end of the "Class A" range, the County should have used predominant market rental rates within that range, or it should have provided evidence to explain why it departed from the predominant rental rate. Such an explanation is particularly necessary where, as here, the County's income figures are not commensurate with the actual income generated from the property. Furthermore, the County's cost approach results in a per unit value of \$112,000, after allowances are made for personal property, which would be nearly \$115,000 per unit if personal property were included. This per unit value is beyond the realm of reasonableness in view of the market data and would appear to belie the County's designation of the subject as a "Class A" property. Therefore, using rental rates above the norm for "Class A" is additionally suspect.

When the predominant market rental rates are applied in the instant case, the estimated net operating income is approximately \$2,090,864. Applying the County's market capitalization rate, the final value is \$24,063,275 (after allowances for personal property). This value also falls within the range of values established by the two transactions involving apartment complexes comparable to the subject property in size, age, number of units, and location.

IT IS THEREFORE ORDERED BY THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS that, for the reasons stated above, the appraised value of the subject property for tax year 2004 is \$24,063,275. **IT IS FURTHER ORDERED** that the appropriate officials are directed to correct the County's records accordingly, re-compute the taxes owed by the Taxpayer and issue a refund for any overpayment.

Any party to this appeal who is aggrieved by this decision may file a written petition for reconsideration with this Board as provided in K.S.A. 77-529, and amendments thereto. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Board's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for

reconsideration shall be mailed to: Secretary, Board of Tax Appeals, DSOB Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. A copy of the petition, together with all accompanying documents submitted, shall be mailed to all parties at the same time the petition is mailed to the Board. Failure to notify the opposing party shall render any subsequent order voidable. The written petition must be received by the Board within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute if the Board serves the order by mail). If at 5:00 pm on the last day of the specified period the Board has not received a written petition for reconsideration, this order will become a final order from which no further appeal is available.

IT IS SO ORDERED

THE BOARD OF TAX APPEALS