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SUSAN M. JONES
CLERK OF THE DISTRICT COURT

IN THE DISTRICT COURT OF MIAMI COUNTY, KANSAS

PAOLA SUNDANCE APARTMENTS I AND II, Petitioners/Appellants,	)	
vs.	)	Case No. 07 CV 249
THE MIAMI COUNTY BOARD OF COUNTY COMMISSIONERS AND MIAMI COUNTY APPRAISER, Respondents/Appellees	)	

JOURNAL ENTRY OF JUDGMENT

NOW, on this 23rd day of June, 2009, the above-captioned action comes on for hearing. Petitioners appear by their counsel, Carol B. Bonebrake. Respondents appear by their counsel, David R. Heger, Miami County Counselor.

The instant action is an appeal from Orders of the then Board (now Court) of Tax Appeals. On March 19, 2009, the parties presented oral arguments to the Court. The Court's review is governed by the Act for Judicial Review and Civil Enforcement of Agency Actions. K.S.A. 77-601 *et seq*. Taxpayers below (Petitioners here) alleged that BOTA

> a. erroneously interpreted and applied the law when it first decided that the directive "taxing authorities should consider the effects of the low-income housing contract when valuing the property for ad valorem taxes" contained in *In re The Equalization Appeal of Ottawa Housing Assoc., L.P.*, 27 Kan. App. 2d 1008, 1011, 1013, 10 P.3d 777 (2000) should be applied "on a case by case basis in light of the specific property at issue and the relevant marketplace" and then adopted valuations which were determined without consideration whether the low-income housing contracts had any effect upon the values of the real property,
>
> b. engaged in an unlawful procedure when it adopted valuations contrary to the holding of *Ottawa Housing*, PVD directives and USPAP standards,

c. made a determination of fact unsupported by substantial evidence when it held that the highest and best use of the subject properties were as market rent properties, and

d. took actions which were unreasonable, arbitrary and capricious.

After reviewing the file, hearing the arguments of counsel, and being fully apprised in the premise, the Court finds as follows:

FINDINGS OF FACT

1. Paola Sundance I and II ("PS I" and "PS II" respectively) are apartment buildings in Paola, Miami County, Kansas. Both have 40 units and both are Section 42 low income housing projects.

2. As Section 42 properties, both properties are subject to a Declaration of Land Use Restrictive Covenants for Low Income Housing Credits (Declaration) between the owner and Kansas Department of Commerce & Housing (KDCH). The Declarations are filed with Miami County Register of Deeds, run with the land, bind future owners to the restrictions on use, occupancy and transfer and require that the properties lease 100% of its units to person(s) whose income is 60% or less than the area's median gross income for a period of 30 years in accordance with the restricted rent structure set by KDCH. The Declarations further allow KDCH to void a sale, transfer or exchange of the property if the buyer does not assume in writing the requirements of the Declaration and IRS Code Section 42.

3. Section 42 refers to the Federal Low Income Housing Tax Credit Program in 26 U.S.C. § 42. Section 42 was designed to encourage investment in low income, multi-family rental housing by providing tax credits which offset an investor's federal income taxes. The federal government has delegated the responsibility of administering the Section 42 low income housing tax credit program to the various states. In Kansas, KDCH allocates the available tax

credits to developers who are proposing to build low income, multi-family rental housing in areas where there is a demonstrated need. Developers apply for a tax credit allocation for their proposed projects and KDCH evaluates the various applications and determines which projects should be approved. The developers sell the tax credits and the proceeds are used to finance construction of the housing project. In return for the allotment of tax credits, the developer must agree to rent the property constructed at restricted rates for a period of 30 years to persons who earn less than 60% of the median income for that geographic area. Failure to adhere to the restrictions imposed by KDCH, acting on behalf of the federal government, subjects the owner of the property to recapture penalties as well as liability (injunctive relief, money damages) under the Fair Housing Act, 42 U.S.C. 3601, *et seq*. Due to the governmentally imposed restrictions, Section 42 properties rarely, if ever, sell.

4. Miami County hired Russ Dillon ("Dillon") to appraise PS I and PS II. At the instruction of Miami County, Dillon appraised the properties in "fee simple without regard to any encumbrances." (Vol. VIII 50). Although Dillon knew the properties were developed as low income housing tax credit projects and were subject to declarations restricting use of the property to low income housing leased to qualified low income renters, Dillon did not consider these encumbrances in his valuations. (Vol. VIII 50-1). Dillon did not take into account the *Ottawa Housing* holding in performing his appraisal of the properties. (Vol. VIII 71). Dillon's 2005 value of PS I was $1,900,000 with a contributory value of personal property of $24,000; his 2005 value of PS II was $2,115,300 with a contributory value of personal property of $34,700.

5. Taxpayers hired Bernie Shaner, MAI, ("Shaner") to appraise the properties. Shaner valued the properties taking into account the low income housing contracts which mandate use of the property as low income housing for a thirty (30) year period. (Vol. VIII 122-

123). Shaner determined the 2005 fair market values of PS I and PS II to be $885,000 and $905,000 respectively.

6. Although Dillon and Shaner both defined a fee simple interest in real estate as "absolute ownership unencumbered by any other interest or estate, subject only to the limitations imposed by governmental powers of taxation, eminent domain, police power and escheat" and agreed that that was the interest to be appraised for ad valorem purposes, Dillon, at the direction of Miami County, did not consider any encumbrances. In contrast, Shaner reviewed the restrictions contained in the Declarations, determined they were limitations imposed by the government exercising its police power, and considered how those restrictions would affect what a well-informed buyer would offer and a well-informed seller would accept for the properties. (Vol. VIII 148-150).

7. BOTA adopted Dillon's value conclusions as the fair market values of PS I and PS II for tax year 2005 even though Dillon did not follow *Ottawa Housing* and consider whether the encumbrances imposed by the low income housing contracts would affect what a well-informed buyer would offer and a well-informed seller would accept for the properties in arms length transactions. Although *Ottawa Housing* required that tax authorities consider the effect low income housing contracts have upon value, BOTA found that such contracts should be analyzed on a "case by case basis in light of the specific property at issue and the relevant marketplace." BOTA rejected the notion that the restrictions in the low income housing contracts were limitations imposed by the exercise of the governmental taxation or police powers and instead concluded that there are no restrictions placed on the use of the real estate at all. (Vol. I 116).

8. Petitioners timely sought reconsideration. Following reconsideration, BOTA upheld its original decision finding that the highest and best use of PS I and PS II was as market rent properties because such use was legally permissible, physically possible, financially feasible and would achieve maximum productivity. Specifically BOTA found that PS I and PS II would not violate any laws by charging market rent for the subject properties. (Vol. II 54). BOTA then reviewed a series of cases from other jurisdictions involving the valuation of Section 42 and other low income properties and concluded that although Dillon, at the instruction of the County, failed to consider the *Ottawa Housing* holding in preparing his appraisals, that omission was "not materially detrimental to the overall opinion rendered as he properly identified the fee simple interest to be appraised." PS I and PS II thereafter timely filed a Petition of Judicial Review.

CONCLUSIONS OF LAW

1. Article 11, Section 1 of the Kansas Constitution mandates that the legislature shall provide for a uniform and equal basis of valuation for all property subject to taxation and not otherwise described. K.S.A. 79-501 requires that "each parcel of real property shall be appraised at its fair market value in money." The purpose of K.S.A. 79-501 is to establish a uniform standard for arriving at a fair and equitable value of property. *Board of County Commissioners v. Brookover*, 198 Kan. 70, 77, 422 P.2d 906 (1967). By requiring that all property be valued at its fair market value, the legislature satisfied the constitutional requirement of uniformity and equality in taxation. *Id.* at 77.

2. K.S.A. 79-503a defines fair market value as "the 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 that the parties are acting without undue compulsion." K.S.A. 79-503a goes on to indicate that the definition assumes a consummation of

a sale as of the January 1 assessment date and provides a laundry list of factors which well-informed buyers and sellers take into account in arriving at fair market value. It is well established in Kansas that compliance with K.S.A. 79-503a is mandatory; failure to consider the K.S.A. 79-503a factors renders an assessment invalid. *Garvey Grain, Inc. v. MacDonald*, 203 Kan. 1, 10, 453 P.2d 59 (1969); *Sunflower Racing, Inc. v. Board of Wyandotte County Commissioners*, 256 Kan. 426, 444, 885 P.2d 1233 (1994).

3. The K.S.A. 79-503a laundry list of factors was not intended to be all inclusive. *Board of Douglas County Commissioners v. Cashatt*, 23 Kan.App.2d 532, 541, 933 P.2d 167 (1997). Other factors which a well-informed buyer and seller consider in determining the market value of real estate have been established judicially. *In re Equalization Appeal of Ottawa Housing Association, L.P.*, 27 Kan.App.2d 1008, 10 P.3d 777 (2000) presented the issue of whether a County's valuation of a Section 42 apartment complex could be sustained when the county appraiser admitted that he did not consider the restrictions imposed upon the rental of the property by the Section 42 low income housing contract. The *Ottawa Housing* taxpayer argued that the county appraiser's admission that he did not consider what effect the restrictions had upon value was tantamount to acknowledging he did not comply with K.S.A. 79-503a. The Court of Appeals agreed that the County's valuation could not satisfy K.S.A. 79-503a, reasoning:

> "'Buyers and sellers of real estate consider these tools [low income housing contracts] in determining the market value of real estate. *See Pedcor Investments*, 715 N.E.2d at 437, *Rebelwood, Ltd.*, 554 So.2d at 1364. This principle corresponds with the Kansas definition of 'fair market value' as 'the 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 that the parties are acting without undue compulsion. K.S.A. 79-503a.'"

27 Kan.App.2d at 1013.

4. In this case, as in *Ottawa Housing*, the appraiser for the County, did not consider the low income housing contracts in determining the market values of PS I and PS II because he was directed to ignore them by Miami County. BOTA attempted to excuse Dillon's failure to comply with the interpretation of K.S.A. 79-503a in *Ottawa Housing* by stating that the effects of low income housing contracts should be analyzed on a case by case basis in light of the specific property and relevant marketplace. That interpretation is contrary to the purpose of K.S.A. 79-501 and K.S.A. 79-503a which is to provide a uniform standard for valuation. Under BOTA's ruling, adherence to K.S.A. 79-501 and K.S.A. 79-503a would, in essence, become a local option; a county would decide on a case by case basis whether or not to comply with K.S.A. 79-503a as interpreted in *Ottawa Housing*. With a case by case application of fair market value, uniformity will not be achieved. Such an interpretation cannot pass muster under Article 11, Section 1 of the Kansas Constitution.

5. K.S.A. 77-621(c)(4) provides that a court shall grant relief from an agency action when "the agency has erroneously interpreted or applied the law." In *Ottawa Housing*, the Court of Appeals interpreted K.S.A. 79-503a as requiring that an appraiser consider the effects of low income housing contracts in arriving at fair market value. It is well established that when a court issues a holding on a point of law, that holding binds all courts of lower rank in subsequent cases where the same legal issue is raised. *See Samsel v. Wheeler Transport Services, Inc.*, 246 Kan. 336, 356, 789 P.2d 541 (1990). As a tribunal inferior to the Kansas Court of Appeals, BOTA was required to follow the holding in *Ottawa Housing*. As a matter of law, BOTA erred when it determined that the various counties could apply the *Ottawa Housing* holding on a case by case basis.

6. Petitioners' second claim is that BOTA engaged in unlawful procedure(s) or failed to follow prescribed procedures thereby requiring that relief be granted pursuant to K.S.A. 77-621(c)(5). In support, Petitioners rely upon the holding in *Board of Saline County Commissioners v. Jensen*, 32 Kan.App.2d 730, 88 P.3d 242, *rev. denied* 278 Kan. 843 (2004) where the Court of Appeals recognized that USPAP standards are embodied in the statutory scheme of valuation and held that "a failure of BOTA to adhere to them [USPAP standards] may constitute a deviation from a prescribed procedure or an error of law."

7. K.S.A. 79-505 authorized the Division of Property Valuation (PVD) to adopt rules and regulations prescribing appropriate standards for performing appraisals. Pursuant to that authority, PVD issued Directive #92-006 adopting the 1992 edition of the Uniform Standards of Professional Appraisal Practice (USPAP). PVD thereafter promulgated a *Subsidized Housing Appraisal Guide* in October 1998 which referenced USPAP Advisory Opinion AO-14 which, in turn, prescribed consistent uniform standards for valuing low income housing projects. AO-14 requires that an appraiser of low income housing projects possess a level of competency which extends beyond a typical residential assignment as the appraiser must, at a minimum, explain the subsidies and incentives and their impact on value in the appraisal report in conformity with Standards Rule 1-2(e), understand the various programs, and be able to analyze the effect of those programs on the market. Similarly, USPAP Standards Rule 1-2 specifies that "In developing a real property appraisal, an appraiser must observe the following specific appraisal guidelines:

> (c) consider easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances or other items of a similar nature."

USPAP Standards Rule 1-3 further requires an appraiser to

> "(a) consider the effect on use and value of the following facts: existing land use regulations, reasonably probable modifications of such land use regulations, economic demand, the physical adaptability of the real estate, neighborhood trends and the highest and best of the real estate."

The comment to USPAP Standards Rule 1-3(a) cautions that the appraiser must avoid stereotyped or biased assumptions relating to race, age, color, religion, gender or national origin or an assumption that racial, ethnic or religious homogeneity is necessary to maximize value. The comment echoes the purpose of and language in the Fair Housing Act which, at 42 U.S.C. § 3602(i), makes unlawful discriminatory housing practices, which include appraisal practices which may discriminate against persons based upon their race, age, color, religion, national origin and gender. *USA v. The American Institute of Real Estate Appraisers*, 442 F.Supp. 1072 (N.D. Ill. 1977) (recognizing it is a violation of FHA to treat race, age, color, national origin, religion and gender as negative factors in determining the value of property used for housing).

8. The value conclusions offered in evidence by Miami County failed to follow the USPAP Standards enumerated above. There is no dispute that Dillon was directed by Miami County not to consider the *Declaration of Land Use Restrictive Covenants for Low-Income Housing Credits* even though USPAP Standards Rule 1-2(c) and AO-14 both require that such declarations, restrictions and covenants be considered. Dillon's values were developed without adhering to the teaching in the PVD *Subsidized Housing Appraisal Guide*. Dillon's highest and best use analysis which concluded that PS I and PS II should be converted to market rent properties failed to consider whether such a conversion would be legally permissible under either Section 42 or the Fair Housing Act. Dillon's justification for not considering the declarations, restrictions and covenants was that he valued PS I and PS II in fee simple. While the two appraisers agreed on the definition of fee simple, they treated the declarations, restrictions and

covenants imposed by Section 42 differently. Shaner concluded the declarations were encumbrances imposed by the exercise of governmental police power. Since his client instructed that he should assume the property was unencumbered, Dillon was not required to and did not make that determination. The position taken by Shaner is well supported by authoritative texts and case law.

9. *The Appraisal of Real Estate*, 12th Edition, defines police power as

> "the right of government through which property is regulated to protect public safety, health, morals and general welfare. Zoning ordinances, use restrictions, building codes, air and land traffic regulations, health codes and environmental regulations are based on police power."

The above definition has been followed in Kansas. *Small v. Kemp*, 240 Kan. 113, 116, 727 P.2d 904 (1986) (police power is the inherent power of government to take action which promotes the public health, safety, welfare or morals). It has long been recognized that legislation geared toward providing decent/affordable housing is authorized by the lawful exercise of the government's police power. *See City Line Joint Venture v. United States*, 503 F.3d 1319 (Fed. Cir. 2007) (discussing whether a low income housing act amendment which disallowed prepayment of mortgages after 20 years absent HUD approval was an extension of the lawful exercise of the governmental police power or legislation aimed at nullification of contract rights). BOTA erred when it concluded that the Section 42 encumbrances were not imposed by the exercise of governmental police power for the purpose of putting low income housing on par with other governmental programs regulating safe driving, water, highway development and public safety. Since Dillon, at the insistence of Miami County, did not consider any encumbrances, the encumbrances which must be considered in arriving at a property's value in fee simple were disregarded. Consequently, Dillon did not follow generally accepted appraisal practices as outlined in USPAP when he ignored the requirements of USPAP Standards Rule 1-

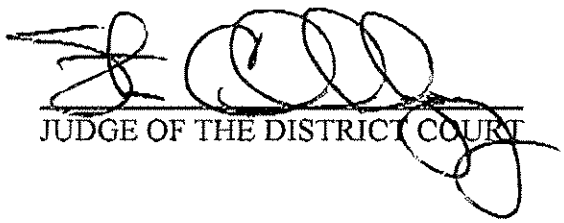
2(c), 1-3(a) and AO-14. BOTA failed to adhere to prescribed procedures when it adopted valuations developed contrary to USPAP Standards. *Jensen*, 32 Kan.App.2d at 730. Under K.S.A. 77-621(c)(5), BOTA's departure from prescribed procedures requires that relief be granted to Petitioners.

10. Petitioners' third and fourth claims for relief are that BOTA made a determination of fact unsupported by substantial evidence when it held that the highest and best use of PS I and PS II were as market rent properties and that BOTA's actions were unreasonable, arbitrary and capricious. Specifically, BOTA found that "Taxpayer is not prevented by any law from selling the subject property for rental at market rates or even charging market rates on its own." Based upon such finding of fact, BOTA applied the highest and best use test (*i.e.* was the use legally permissible, physically possible, financially feasible and achieve maximum productivity) and determined the highest and best use of PS I and PS II were as market rent properties. In so doing, BOTA ignored the provisions in Section 42 which allows government to take enforcement actions to require that the property continue as a low income housing project (*i.e.* KDCH may void a sale, transfer or exchange of the property if the buyer does not assume in writing the requirements imposed by the Declaration and Section 42). BOTA further ignored provisions in the Fair Housing Act, 42 U.S.C. §§ 3601-3619, which allow government and protected persons to enforce the provisions of the low income housing contract. Dillon did not consider whether the use of PS I and PS II as market rent properties were legally permissible because he did not consider the encumbrances. Shaner, on the other hand, considered the encumbrances and determined that the highest and best use of the properties was to continue as low income housing. BOTA erred when it found there was substantial evidence to the contrary. BOTA ignored the holding in *Ottawa Housing* that buyers and sellers consider the low income housing

contracts in determining the market value of the real estate without hearing any evidence to the contrary. Even Dillon acknowledged that the Section 42 restrictive covenants would reduce the rent potential and most likely adversely affect the market value of the properties (Vol. VIII 67-8). When the actions of an agency such as BOTA are overtly and patently in violation of law or are unreasonable, those actions must be set aside pursuant to K.S.A. 77-621(c)(7) and (8).

11. At BOTA, the County had the burden of proof. K.S.A. 79-1609. The valuations offered by Miami County did not achieve fair market value as defined in K.S.A. 79-503a and interpreted in *Ottawa Housing*. Petitioners' appraiser, in contrast, applied *Ottawa Housing* in arriving at the fair market values of PS I and PS II. While it is disturbing to the Court that Miami County instructed its hired appraiser to ignore encumbrances in the face of an appellate decision holding otherwise, this Court is compelled to: (1) reverse the appealed portions of the BOTA Orders establishing the 2005 values of PS I and PS II; and (2) remand the matter to BOTA/COTA for a determination of valuation consistent with this opinion.

IT IS SO ORDERED.



JUDGE OF THE DISTRICT COURT

Copies of the foregoing were forwarded to:

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