STATE OF MICHIGAN

COURT OF APPEALS

FREEDOM VILLAGE OF HOLLAND,

Petitioner-Appellant/
Cross-Appellee,

v

CITY OF HOLLAND,

Respondent-Appellee/
Cross-Appellant.

UNPUBLISHED
April 24, 1998

No. 192090
Michigan Tax Tribunal
LC No. 170827

Before: Griffin, P.J., and McDonald and O'Connell, JJ.

PER CURIAM.

Petitioner appeals by right the Michigan Tax Tribunal's (Tribunal) computation of the true cash value of a piece of commercial property for purpose of assessing ad valorem taxes for the tax years 1992 and 1993. Respondent cross-appeals certain aspects of that computation. We affirm in part, reverse in part, and remand.

The commercial property at issue is a retirement housing complex for senior citizens located in Holland, Michigan. The property is located on a site containing approximately eleven acres, of which approximately 9.2 acres relates to the retirement community. The subject property includes a 501,959 square foot, seven-story senior citizen apartment complex, which was constructed in 1990 and 1991, and includes 347 rentable units and seven guest rooms.[1] The building also contains common use areas which include a two-story theater, central dining facilities, a full-service bank, a barber shop, laundry rooms, a gift shop, a medical clinic, a delicatessen, a convenience store, a library, and exercise room/gymnasium, an indoor heated pool and spa, an auditorium, a post office, a billiards room, a woodworking shop, and a meditation chapel. The final construction cost of the property, as of December 31, 1992, was $31,500,000.

The subject property generates revenue from four primary sources: entry fees, resident service fees, other resident services, and interest income. The entry fee is a lump sum deposit paid by a resident upon execution of the residency agreement. In most cases, the resident's estate is refunded half

of the entrance fee upon the resident's death. Initial entry fees for the property range from $35,000 for a one-bedroom efficiency (452 square feet) to $146,000 for a two-bedroom suite (1,750 square feet). The average entry fee paid by the initial residents was $85,050 for 1991 and $90,200 for 1992. In exchange, the residents receive health care and related services, insurance-type benefits, and occupancy at the subject property.

Residents are also charged monthly "service fees" to cover operating and maintenance costs at the subject property. Resident service fees are based upon the size of the apartment unit, the location of the unit, and the number of unit occupants. Initial service fees ranged from $750 per month for an efficiency and $1,325 per month for a two-bedroom suite. A charge of $400 per month was added for additional occupants. "Other resident services" include rent from the beauty parlor/barber shop and income from guest meals, guest rooms, the delicatessen and general store. Petitioner also generates revenue from interest income.

Petitioner contended that the true cash value of the real property was $12,747,400 in 1992 and $13,646,000 for 1993. Respondent, in contrast, assessed the property at $27,500,000 in 1992 and $32,000,000 for 1993. After rejecting both parties' appraisals, the hearing referee made an independent assessment of the true cash value of the property based on the evidence presented. The referee determined that the income derived from the entry fees was business value that was properly excluded from the taxable property, but that income derived from the monthly service fees should be included as a relevant factor in determining what the property would sell for. The referee rejected petitioner's contention that the building should be valued as if vacant and available for sale, and found that the unit rental prices projected in petitioner's appraisal required an upward adjustment to account for the modernity of the facility and its superior construction and amenities. After making deductions for operating expenses and petitioner's cost to complete the facility in 1992, the hearing referee arrived at a true cash value for the property of $23,716,700 in 1992 and $24,159,200 in 1993. These revised assessments were affirmed by the Tribunal.

Appellate review of Tribunal decisions is limited. *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 482-483; 473 NW2d 636 (1991). In the absence of fraud, the Tribunal's factual findings are conclusive if supported by competent, material, and substantial evidence on the whole record. Const 1963, art 6, § 28; *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 476; 518 NW2d 808 (1994). Substantial evidence "is that which a reasonable mind would accept as adequate to support a decision," and may be less than a preponderance of the evidence. *McBride v Pontiac School Dist (On Remand)*, 218 Mich App 113, 123; 553 NW2d 646 (1996). "Under this test, it does not matter that the contrary position is supported by more evidence, that is, which way the evidence preponderates, but only whether the position adopted by the agency is supported by evidence from which legitimate and supportable inferences were drawn." *Id.*; see also *Sweepster, Inc v Scio Twp*, 225 Mich App 497, 502; 571 NW2d 553 (1997).

Ad valorem taxation is governed by Const 1963, art 9, § 3, which provides that the Legislature must determine appropriate methods for determining the "true cash value" of real and tangible personal property not exempt from taxation. MCL 211.27(1); MSA 7.27(1) provides that "cash value" refers to the "usual selling price" - the "price that could be obtained for the property at private sale . . . ."

Several methods of arriving at the true cash value are commonly accepted in Michigan: the cost-less-depreciation approach, the market comparison approach, and the income capitalization approach. *Meadowlanes, supra* at 484-485. In this case, the Tribunal utilized an income capitalization approach that was based in part on unit rental rates that were adjusted to reflect market rent based on a comparison of similar properties.

Petitioner's first argument on appeal is that the Tribunal's conclusions concerning market rent are not supported by competent, material and substantial evidence. Specifically, petitioner argues that the Tribunal's judgment should be reversed because the market rent utilized by the Tribunal is greater than any comparable rent described or expressed in the record. The Tribunal held that petitioner's projected unit rental prices required an upward adjustment because the subject property is newer and has better construction and superior amenities than the five comparable properties offered by petitioner. The Tribunal therefore concluded that petitioner's appraisal gave "an incomplete analysis of market rental rates by failing to make adjustments for all the obvious dissimilarities between subject and the comparables as presented." On appeal, petitioner does not even address the need for upward adjustments. After reviewing the comparable properties offered by petitioner, we conclude that the Tribunal's determination is supported by "competent, material and substantial evidence." Const 1963, art 6, § 28; *Michigan Bell, supra* at 476.[2]

Petitioner next contends that the Tribunal erred by failing to fully account for the expenses associated with its leased land. Petitioner does not contest the Tribunal's deduction for land rental. Rather, petitioner argues that the Tribunal should also have deducted real estate taxes as an expense. The Tribunal recognized petitioner's contention, and noted that there are generally two methods of adjusting the income for real estate taxes: "(1) as a fixed expense, or (2) as an addition to the total capitalization rate." In its final opinion, the Tribunal found that the taxes were accounted for as an addition to the capitalization rate. On appeal, petitioner argues that the capitalization rate employed by the Tribunal accounts for taxes attributable to the subject property alone, and does not account for property taxes related to the underlying land, which should be deducted as an operating expense.

The Tribunal utilized the 15.5% capitalization rate recommended in petitioner's appraisal. That capitalization rate included a 3% addition to account for property taxes; however, it is not clear from the record whether the taxes taken into account included the underlying real estate taxes as well as the personal property being valued. Consequently, the Tribunal's determination that the 3% increase in the capitalization rate included real estate taxes was not supported by substantial evidence. Consequently, we find it necessary to remand this case to the Tribunal for consideration of the extent to which petitioner's payment of real estate taxes may affect the valuation of the property.

Petitioner's next argument concerns the "cost-to-complete" adjustments. The crux of petitioner's argument appears to stem from the fact that rental income from the unfinished units was included in the calculation of capitalized gross income. The Tribunal recognized that a deduction was necessary for the cost-to-complete interior finish work on some units. The Tribunal adopted respondent's data, which indicated that 130 units remained unfinished in 1992 at a cost of $325,000 and thirteen units in 1993 at $32,500.[3] The Tribunal rejected petitioner's additional deduction for lost income due to the unfinished units, noting that the deduction was a "double accounting of costs" and

that it was "excessive in the measurement of a market value reduction for a temporary condition." According to petitioner, the Tribunal should have deducted for lost income and other expenses involved in obtaining occupants. However, we agree with the Tribunal's conclusion that these are business expenses that are not properly included in the valuation of the property. As respondent points out on appeal, the property was fully leased by 1994.

Next, petitioner asserts that the Tribunal's inclusion of value attributable to hypothetical, non-existent leases constitutes a wrong principle and a reversible error of law. Essentially, petitioner claims that the value of the income from the monthly unit rentals is an intangible business asset that cannot be included in the valuation of the property. We disagree. Section 27(1) specifically provides that the present economic income of leased or rented property is properly taken into account when determining its value. The expected income derived from the rental of real property is fundamental to the use of the capitalization of income approach, which petitioner agrees is the appropriate methodology for valuation of the property. *Meadowlanes, supra* at 485 n 20; *Antisdale v City of Galesburg*, 420 Mich 265, 276-277; 362 NW2d 632 (1985). As the Tribunal noted, although a property may be appraised as "vacant and available for sale," this valuation is appropriate only when it is determined that the current use of the property would not be continued. See, e.g., *Safran Printing Co v Detroit*, 88 Mich App 376, 382-383; 276 NW2d 602 (1979). We find the Tribunal's factual determination that a prospective buyer would continue the use of the property as a retirement housing complex to be fully supported by the record. Moreover, the Tribunal and the hearing officer utilized the same projected 5% vacancy rate that was employed in petitioner's own appraisal, which characterized the monthly unit rental fees as revenues produced by the property. Although not leases, the residency life care contracts obligate the parties as certainly as any lease would.

Petitioner also argues that the income from the rentals is excludable because only the fee simple interest in the property is subject to assessment, petitioner's fee simple interest consists of the right to use and enjoy the property, which petitioner has conveyed to the residents of the complex, and the reversionary rights remaining with petitioner. See *Meadowlanes, supra* at 485 n 20. Petitioner essentially claims that only the reversionary rights that entitle petitioner to retake possession of the property when the residents leave, or to sell the property subject to the conveyance, constitute its assessable fee interest in the property; however, these rights alone constitute only one part of the entire fee interest. The income that may be realized as a result of the assignment of a portion of petitioner's fee simple rights in the property is properly considered in the determination of the value of the entire fee interest. *Id*. Consequently, we find that the tribunal's decision with regard to this issue was consistent with applicable law and valuation principles and supported by substantial evidence.

Const 1963, art 9, § 3 requires that property be assessed uniformly at a maximum of 50% of its true cash value. Petitioner claims that the Tribunal erred as a matter of law when it determined that petitioner's assessment conformed with the average level of assessment in the county. However, whether property is assessed uniformly is a factual finding that is binding on this Court if supported by competent, material and substantial evidence. *Wolverine Tower Associates v City of Ann Arbor*, 96 Mich App 780, 783; 293 NW2d 669 (1980). The parties agree that the average level of assessment in the county for personal property was 49.91% for 1992 and 49.52% for 1993. The only witness to

testify with regard to this issue stated that application of an equalization factor is appropriate only if the overall ratio of assessment in the district is below 49% percent. Petitioner has cited no authority in support of its contention that an equalization factor must be applied whenever there is any difference, no matter how slight, between the average level of assessment and its assessment; in fact, petitioner has cited no authority whatsoever in connection with this argument. Consequently, we consider the issue to be abandoned. *Marx v Dep't of Commerce*, 220 Mich App 66, 81; 558 NW2d 460 (1997).

Petitioner raised a constitutional challenge to the 1991 amendments to the General Property Tax Act in its motion for summary disposition, which was denied without any further comment by the Tribunal. In that motion, petitioner claimed that under 1991 PA 15, its assessment for 1992 should have been the same as it was for 1991. 1991 PA 15, § 2 amended MCL 211.10; MSA 7.10 to provide as follows: "In 1992, the assessment as equalized for the 1991 tax year shall be used on the assessment roll and shall be adjusted to only reflect additions and losses as those terms are defined in section 34d [MCL 211.34d; MSA 7.52(4)]. Additions shall be valued at 1991 levels." This enactment "froze" property taxes at 1991 levels for tax year 1992 only. On the relevant tax date for 1991, which was December 31, 1990, the subject property was a construction site assessed at $48,100, or 50% of its true cash value. On December 31, 1991, the relevant tax date for 1992, the property was assessed at $11,022,700 due to new construction completed during 1991, the value of which had been defaulted to 1991 price levels. Petitioner claims that the property's permissible assessment is constitutionally limited to $48,100 for 1992 because taxing the value of additions without taxing added value created by inflation or market factors violates the mandate of uniformity contained in art 9, § 3 of the Michigan Constitution; alternatively, petitioner argues that the assessment for 1992 should have remained at $48,100 because the additional construction did not exist on December 31, 1990. We disagree.

The Tribunal has no jurisdiction to decide constitutional questions and no authority to invalidate statutes. *Wikman v Novi*, 413 Mich 617, 647; 322 NW2d 103 (1982). The circuit court has jurisdiction over constitutional challenges to tax statutes. *Joy Management Co v Detroit*, 176 Mich App 722, 728; 440 NW2d 654 (1989); *Kostyu v Dep't of Treasury*, 170 Mich App 123, 128; 427 NW2d 566 (1988). Because either of petitioner's resolutions of this issue would have required the Tribunal to invalidate as unconstitutional all or a portion of 1991 PA 15, we conclude that the tribunal did not err in refusing to consider this claim.

Finally, petitioner contends that respondent bore the burden of proof before the Tribunal with regard to its position that the assessment should have been higher than the amount determined by the hearing officer. However, it is established by statute that the burden of proof in proceedings before the Tribunal is always on *the petitioner* to establish the true cash value of the property. MCL 205.737(3); MSA 7.650(37)(3). Once again, petitioner has directed our attention to no authority that would justify transferring the burden of *proof* to respondent with regard to any aspect of the proceedings below, although as noted in *Jones & Laughlin Steel Corp v City of Warren*, 193 Mich App 348, 355-356; 483 NW2d 416 (1992), the burden of *persuasion* may at times shift to the respondent. Consequently, we find this issue to be meritless.

Although respondent raises two issues in connection with its cross-appeal, only one was preserved for review by this Court because it was raised before and addressed by the Tribunal.[4] *Town & Country Dodge v Dep't of Treasury*, 420 Mich 226, 228 n1; 362 NW2d 618 (1984). Respondent claims that the Tribunal erred as a matter of law when it failed to include the value derived from the entrance fees, also referred to as life care contracts, in determining the true cash value of the property. The Tribunal found that "the availability of life care services is an intangible value-influencer in the same manner as other value-influencing factors such as amenities, common areas . . . location, existing use, and present economic income of structures." The Tribunal concluded that the income from the life care contracts was properly excluded from the valuation of the property because it was income from business operations conducted on the premises. Respondent argues that business value is assessable under the statutory definition of true cash value and that petitioner failed to carry its burden of proof with regard to establishing the existence of a separate and intangible business value.

We begin by noting that Const 1963, art 9, § 3 permits only the taxation of tangible property. It is well established in our jurisprudence that intangibles are not generally taxable in and of themselves, but may be considered in the valuation of property where they affect its market value. *Michigan Bell*, *supra* at 485-486; *Meadowlanes*, *supra* at 495-496; *Antisdale*, *supra* at 285. In determining the true cash value of property, the Legislature has expressly stated that the "present economic income of structures" is one factor that may be taken into consideration as an intangible influencing value, similar to location, zoning, etc. MCL 211.27(1); MSA 7.27(1). However, as we have noted, such intangibles are not themselves taxable property subject to assessment. *Meadowlanes*, *supra* at 495-496; *Antisdale*, *supra* at 285. Consequently, to the extent that respondent asserts that the entry fees themselves are assessable, we reject its argument.

The Legislature has defined "present economic income" to mean, "in the case of leased or rented property, the ordinary, general and usual economic return realized from the lease or rental of property . . . ." MCL 211.27(4); MSA 7.27(4). Thus, it is apparent that the entry fees may be taken into consideration in determining the value of the property only to the extent that they represent income derived from the rent or lease of the property.[5] Respondent argues that the entrance fees associated with the life care contracts are, in their entirety, rental income that must be included in the valuation of the property under the income capitalization approach. Whether the income from the entry fees constitutes rent or income from business operations constitutes a question of fact, the Tribunal's determination of which is final on appeal to this Court if it is supported by competent and substantial evidence. Const 1963, art 6, § 28; *Meadowlanes*, *supra* at 482.

We find that the Tribunal's determination that the life care contracts were contracts for services to be supported by substantial evidence in the record. Respondent's own brief on appeal characterizes these agreements as establishing a contractual relationship obligating the owner to provide residents with a "continuum of care" progressing from independent living to assisted living to nursing care. The entrance fees are held in trust, and under normal circumstances 50% of the fee will be refunded to a resident or his estate upon termination of the contract, while the remainder pays for the services provided to residents as outlined in the agreement. Thus, "the ordinary, general and usual economic

return realized from the lease or rental" of the subject property does not include any income from entrance fees. MCL 211.27(4); MSA 7.27(4).

While the possibility exists, pursuant to paragraph 8.03(b)(4) of the agreement, that some of the refundable portion of the entrance fee may be used to pay a resident's monthly unit rental fee in the event that the resident's other sources of income become exhausted, the entrance fee does not become "present economic income" derived from the rental or lease of the property unless and until it is actually used to pay the unit rental fees. The income capitalization approach to valuation assumes a consistent stream of income from the property; the portion of the entrance fees held in trust merely insures the reliability of that stream of income. To the extent that the interest earned on the entrance fees enhances petitioner's income such that petitioner is able to set its monthly unit rental fees below market rent, the benefits derived from this arrangement are adequately accounted for in the upward adjustment of the monthly unit fees to reflect market rent. Consequently, we find that respondent's claim that the entrance fees should have been included in the valuation of the property to be without merit.

In conclusion, we remand the case to the Tribunal for a determination of whether petitioner's payment of the real estate taxes on the underlying land was taken into consideration in the valuation of the property, but affirm in all other respects. We do not retain jurisdiction.

/s/ Richard Allen Griffin
/s/ Gary R. McDonald
/s/ Peter D. O'Connell

[1] The subject property includes both real property improvements located on leased land and taxable tangible personal property located within such property. Because none of the issues raised in connection with this appeal challenge the tribunal's valuation of the personal property consisting of furniture, fixtures and equipment, we conclude that this valuation is uncontested.

[2] Although the actual monthly charges were somewhat lower than the market value attributed to the unit rental fees by the tribunal, that fact does not require a different result. MCL 211.27(4); MSA 7.27(4) defines "present economic income" as, "in the case of leased or rented property the ordinary, general and usual economic return realized from the lease or rental of [similar] property negotiated under current, contemporary conditions . . . ." The statute further provides that "[t]he actual income generated by the lease or rental of property shall not be the controlling indicator of its cash value in all cases." We find the use of the "market rent" approach to be especially appropriate in cases such as the present one, in which creative financial arrangements have the effect of generating artificially low rents.

[3] The Tribunal found that respondent's cost calculations were "more probative, substantial, and reliable" than those of petitioner because respondent's data was based on information obtained from the subject property's manager, a source not utilized in petitioner's report.

[4] Respondent's argument that its discounted cash flow method more accurately determined the capitalized income of the property was neither raised before nor addressed by the Tribunal.

[5] We find the authorities relied on by respondent, specifically *Dowagiac Lid Dividend Housing Ass'n v Dowagiac*, 166 Mich App 232; 420 NW2d 114 (1987), and *Southfield Western, Inc v Southfield*, 146 Mich App 585; 382 NW2d 187 (1985), to be of little value in the determination of this issue because the income at issue in both those cases was clearly income derived from the rental or lease of the subject properties that was properly taken into account in the determination of the true cash value of the properties. Nor do we agree with respondent's characterization of petitioner's burden of proof with regard to this issue. To the extent that there may be a dispute with regard to whether particular income is derived from the rental or lease of the property, it is true that petitioner bears the burden of proving that such income is properly excluded from the determination of the true cash value of the property. MCL 205.737(3); MSA 7.650(37)(3). However, this does not mean that the petitioner bears the same burden of proof with regard to all income derived from business operations conducted on the premises; such income is not properly taken into account in the determination of the market value of the property because, as noted, "present economic income" has been expressly limited by the Legislature to income derived from the rental or lease of the property. MCL 211.27(4); MSA 7.27(4).