IN THE MAGISTRATE DIVISION
OF THE OREGON TAX COURT
Property Tax

FOREST HEIGHTS APTS LLC,	)	
	)	
Plaintiff,	)	No. 000575D
	)	
v.	)	
	)	
CLACKAMAS COUNTY ASSESSOR,	)	
	)	
Defendant.	)	**DECISION**

Plaintiff appeals the real market value of its improvements for the tax year 1999-2000. A telephone trial was held on Tuesday, January 23, 2001. Mr. Scott Phinney, Attorney, appeared on behalf of plaintiff. Mr. Bjornson, licensed broker and owner of the subject property, and Mr. Jack Milner, broker, testified for plaintiff. Mr. John Taylor, Appraiser II, appeared on behalf of defendant.

During preliminary matters prior to commencing the proceeding, Mr. Taylor asked the court's permission to modify its written determination of real market value for the subject property as follows. Defendant concludes that the real market value of the 65 unit apartment building was $3,708,580 as stated on the tax roll. The real market value of the 8 duplex units was $796,800, for a total 1999-2000 real market value for the subject property of $4,505,380. The 1999-2000 real market value on the tax roll was $4,710,430. Plaintiff had no objection. The court granted defendant's request.

At the conclusion of the trial, the parties agreed to submit written closing arguments. On February 23, 2001, plaintiff submitted its closing arguments. On March 8, 2001, defendant submitted its closing arguments. Defendant requested that the court sustain the real market value on the tax roll for the 65 apartments ($3,708,580) and reduce the real market value on the tax roll for the 8 duplex units to $99,600 per unit or $796,800. (Def's

Closing Arguments at 12.) Defendant's suggested total real market value for the 1999-2000 tax year would be $4,505,380 which is the same real market value orally presented to the court. On April 2, 2001, the court received Plaintiff's Closing Argument - Reply.

STATEMENT OF FACTS

Plaintiff's property consists of a 65 unit apartment building and 8 duplex units located on 8.52 acres in Oregon City, Oregon. Mr. Bjornson testified that in 1996/97 he developed the subject property at a cost of approximately $3,700,000. The total construction cost included approximately $1,000,000 in cost over runs for faulty construction such as failure to properly seal the foundation and substantial electrical rework. In addition to the 2 ½ story apartment building and duplex units, the residents have access to a small recreation room and a playground for children. There is no covered parking for the apartment residents; each duplex resident has a single car garage.

Mr. Bjornson briefly described the difficulty he encountered in obtaining city approvals to construct the apartment building. Because the neighboring residents objected to an existing apartment complex located across from Mr. Bjornson's proposed development, the city required Mr. Bjornson to build 8 duplex units facing the residential neighborhood. He testified that it is not financially feasible for him to sell one or more of the duplex units because the entire subject property is encumbered by one mortgage with a substantial pre-payment penalty. While each duplex unit has its own separate tax account, only one unit, Lot 1, has its own separate sewer connection.

Mr. Bjornson testified that the subject property is surrounded by "hundred year old residences" which are not maintained and cluttered with "junk." He testified that the surrounding neighbors have negatively impacted the rent he can charge for the apartment and duplex units. In addition, Mr. Bjornson testified that the rental market in Oregon City

has been weak. In order to secure tenants, Mr. Bjornson offered incentives including one and one-half months free rent and no security deposit. He testified that in the Oregon City/Gladstone area rents dropped 1.67 percent during the time period winter 1998 to winter 1999. (Ptf's Ex 37.) After three years of operation, Mr. Bjornson testified that he is no longer forced to offer these incentives.

Mr. Bjornson testified that based on his 27 years of experience as a broker and investor, a buyer looks to actual rather than pro forma operating data when purchasing an income property such as the subject property. In this case, the most reliable operating data is the 1999 year because in Mr. Bjornson's words "it is more stable" whereas the prior year the property was new and not fully rented. In looking to the future, Mr. Bjornson testified that expenses, such as telephone, sewer and maintenance, are increasing at a rate in excess of what he can pass on to his tenants through an annual rent increase. Because of the "high uncertainty of the neighborhood" and increasing expenses, Mr. Bjornson concluded that a capitalization rate of 8.75 to 9 percent is appropriate.

Mr. Jack Milner testified that he prepared the opinion of value submitted by plaintiff. Mr. Milner testified that he used comparable sales of similar properties which he inspected. He testified that the sale price of each comparable property was reduced to a value per unit which was multiplied times a net operating income (NOI) ratio. The NOI ratio was a percentage computed by dividing the comparable properties NOI by the subject property's NOI. These adjusted per unit values were averaged and multiplied by the number of total units of the subject property resulting in an indicated value for the subject property of $3,779,356. (Ptf's Ex at 4.) In addition, Mr. Milner stated that he computed a sales price per square foot which was multiplied by a NOI ratio (computed as previously described) to compute an adjusted sales price per square foot. Once again, Mr. Milner

computed an average adjusted sales price per square foot which was multiplied times the total square footage of the subject property to compute an indicated value for the subject property of $3,786,824. *Id.*

Mr. Milner briefly described each of the six comparable properties. According to Mr. Milner, the first comparable property (CP No. 1), a 127 unit complex, is located on Monroe Street in Milwaukie, Oregon, a "good area" close to bus transportation. (Ptf's Exs at 17 - 19.) It was built in 1991 and is in "good quality." *Id.* CP No. 1 provides several amenities to the residents, including a pool and recreation room, and over half of the available parking spaces are covered carports. The second comparable property (CP No. 2) is located on Redwood Street in Canby, Oregon. (Ptf's Exs 20 - 22.) It is a 67 unit apartment complex with 57 covered carports and a large recreation room. The third comparable property (CP No. 3) was built in 1996 and is located on Fuller Road in Milwaukie, Oregon. (Ptf's Exs 23 - 25.) Mr. Milner testified that CP No. 3 has less apartment units (42) than the subject property and a children's playground, but no recreation room or covered parking. Plaintiff did not include this comparable sale in its indicated value computations because the sale occurred March 31, 2000. The fourth comparable property (CP No. 4), located in Southeast Portland, was built in 1999 and is a single secured building with underground parking. (Ptf's Exs 26 - 28.) Mr. Milner characterized the apartment complex as "upscale" and its value increased due to its location across from the MAX light rail. With a total 51 units, the buyer agreed to reduce the rent on 11 units; in exchange, the buyer "would receive a tax exemption." (Ptf's Ex at 28.) The fifth comparable property (CP No. 5) is located on Bell Avenue in Milwaukie, Oregon. (Ptf's Exs 29 - 32.) CP No. 5 was built in 1994 and with 174 units is substantially larger than the subject property. Tenant amenities include 19 garages, pool and recreation

room. The sixth comparable property (CP No. 6) is located on Hazel Dell Avenue in Vancouver, Washington. (Ptf's Exs 33 - 36.) The 200 unit apartment complex was built in 1995 and includes a pool, and recreation and gym rooms, but no covered parking. Mr. Milner testified that it was in "good quality." Mr. Milner testified that all of the comparable properties are in superior locations to the subject property except CP No. 2 and the construction quality of the comparable properties is similar to the subject property with the exception of CP No. 3.

Mr. Milner testified that the 8 duplex units of the subject property were built "below grade" with a shared easement. In his opinion, Mr. Milner believes that the duplex units should be valued as they exist and "not as if drastic changes were made such as separate sewers and water meters for each duplex."

Mr. Taylor testified that the 8 duplex units are "single family residences" with only one common wall, allowing the units to be sold separately. Mr. Taylor stated that the plaintiff's mortgage is the "problem of the current owner" and a buyer would get a new loan. Mr. Taylor testified that each duplex had its own yard, e.g., front, back and one side, and its own garage. Mr. Taylor supported his testimony by reference to comparable sales data for 3 attached single family homes. (Def's Ex at 19.) All 3 single family residences selected as comparables were substantially larger (1,237 - 1,542 square feet) than the subject duplex units (1,002 square feet). One of the comparable properties located in Southeast Portland had a finished basement which Mr. Taylor concluded made it less desirable than the subject duplex units. However, Mr. Taylor concluded that it was the "closest in overall desirability to the subject"; the sales price in August, 1998 was $134,900. The comparable sales ranged in price from $134,900 to $173,900. None of the comparable properties were located in Oregon City. One sale occurred in August

2000. The comparable sales were not adjusted for location, time, size, or age.

During cross-examination by Mr. Phinney, Mr. Taylor was informed that in order for plaintiff to build the apartment project, plaintiff was required to build the 8 duplexes which are located on "non-conforming lots." Mr. Phinney reviewed the two final orders of the Oregon City planning commission dated June 26, 1990, and Oregon City planning commission dated February 5, 1992. (Ptf's Exs 3 and 4.) After discussion, Mr. Taylor revised his value determination for the 8 duplexes based on each unit's average monthly rent. The average monthly rent was annualized and multiplied times a gross income multiplier of 7.5 to compute a per unit value of $72,000 or $576,000 for all 8 duplex units.[1]

Mr. Taylor testified that in computing the indicated value of the 65 apartment units he used the proforma net operating income in accordance with The Appraisal of Real Estate, 11th edition. Mr. Taylor testified that proforma net operating income is based "on the way properties tend to sell." He testified that because actual net operating income is subject to "lots of different decisions" in any given year, it is accepted practice to use pro forma net operating income. In this case, Mr. Taylor testified that because 1999 was the first year that the subject property was fully occupied the net operating income was not "representative" because of extra maintenance and advertising expenses incurred when tenants vacate the units. Mr. Taylor concluded that based on his pro forma computations, the 1999-2000 real market value for the 65 units should be the tax roll value, $3,708,580.

During cross-examination, Mr. Taylor stated that he did not use the actual property taxes paid by plaintiff in computing a property tax rate. Mr. Taylor computed the property tax rate based on the real market value of the property. He explained that because the

---

[1] In defendant's written Closing Argument, Mr. Taylor wrote that the "value as an apartment was estimated by taking the gross rent of $77,220 times the GIM of 7.5. This makes the value $579,150, or $72,393 per unit." (Def's Closing Argument at 2.)

actual property tax paid by plaintiff was based on assessed value and not real market value it would be incorrect to use actual taxes paid to compute a property tax rate to develop a capitalization rate. (Def's Ex at 15.)

COURT'S ANALYSIS

In order to determine the 1999-2000 real market value of plaintiff's property, the court must first consider whether the 8 duplex units should be valued as single level apartments similar to the other 65 apartment units. Plaintiff alleges that the highest and best use of the property is its current use as an apartment project. (Ptf's Ex 2.) Defendant contends that each of the duplex units could be sold separately, resulting in the highest and best use as single family residences, not rentals.

There are two main reasons for analyzing the highest and best use of property as improved. (The Appraisal of Real Estate, 11th ed. at 303.) The first reason that is relevant to this case is to identify the property use that can be projected to result in the highest overall return to the investor. *Id.* In determining whether the subject property's highest and best use is its current combination of duplex and apartment units, the first considerations are the tests of physical possibility and legal permissibility. *Id.* at 306. Defendant contends that the "City of Oregon City planning department sees no legal" or physical "reason why these attached single family residences could not be sold separately." (Def's Closing Arguments at 2.) However, defendant failed to submit any written statements signed by representatives from the planning department and no one from the planning department was called as a witness during the trial.

The court must look to the evidence when considering these two tests. After a lengthy approval process including multiple reviews by the Oregon City Planning Commission and appeals to the State Land Use Board of Appeals, the final plan permitted

the construction of 73 new units, 65 apartment units and 8 duplex units. (Ptf's Ex 3, City of Oregon City, City Commission, Final Order, dated February 5, 1992.) In accordance with this plan which was considered an expansion of a neighboring apartment planned development project, the duplex units were placed on lots which did "not meet the minimum lot area or width of the R-6" (single family residential) "zone." *(Id.* at 11, Findings of Fact.) The duplex units were located on lots that are "typical of lots" located in the nearby Barclay Hills Planned Development which is zoned RA-2 Multi-Family Residential. *Id.* In addition, the lots with the duplex units did not meet "the minimum requirement of 45 feet of street frontage." *Id.* The units were located below the grade of the road and access was permitted through the apartment building parking lot. *Id.* The apartment building has its own sewer connection; the duplex units share a single sewer connection. Each of these factors constricts the value of the duplex units as a single family residence. The court does not find defendant's single family comparable sales analysis persuasive because the adjusted sales prices were not adjusted for location, size, age and time. Given the site, access, sewer and frontage restrictions, even assuming there are no legal or physical reasons why the units could not be sold as single family residences, the current use approved by the city planning commission is the most likely use to produce the highest overall rate of return for the owner-landlord.

Having determined that the value of the duplex units should be based on their use as rental income properties, the next issue before the court is the 1999-2000 real market value of plaintiff's property. Real market value is the standard used throughout the ad valorem statutes except for special assessments. *Gangle v. Dept. of Rev.*, 13 OTR 343,

345 (1995). Real market value is defined in ORS 308.205(1)[2] which reads:

> "Real market value of all property, real and personal, means the amount in cash that could reasonably be expected to be paid by an informed buyer to an informed seller, each acting without compulsion in an arm's length transaction occurring as of the assessment date for the tax year."

The court looks for arm's length sales transactions of property similar in size, age, income characteristics and location to plaintiff's property in order to determine the real market value. Plaintiff's comparable sales data included six sales, none of which were within plaintiff's neighborhood. Plaintiff's sales grid excluded one sale which occurred in March, 2000. (Ptf's Ex at 4.) Plaintiff incorrectly computed the per-tax NOI for CP No. 5 (Bell Avenue) as $1,020,954; it should be $920,954. As a result, plaintiff's indicated values based on per unit and per square feet were understated. After correction of the CP No. 5 pre-tax NOI, the indicated value in both cases is approximately $3,850,000. In contrast, defendant determined that based on four comparable sales including plaintiff's CP Nos. 3, 4 and 6 and one sale in the Oregon City area that the real market value of the 65 apartment unit building was $58,000 per unit or approximately $3,800,000. During the proceeding, Mr. Taylor suggested that the 8 duplex units should be valued at $72,000 per unit or $576,000 for a total real market value of $4,376,000. Mr. Taylor determined the value of each duplex unit by taking an estimated gross rent of $77,220 times the gross income multiplier of 7.5. However, Mr. Taylor subsequently revised his oral testimony when he submitted his written closing argument. He concluded that the real market value should be $99,600 for "each residence", resulting in a real market value of $4,505,380 for the subject property. (Def's Closing Argument at 2.)

---

[2] All references to the Oregon Revised Statutes are to the 1997 Replacement Part.

Looking at the characteristics of the properties selected as comparable sales, the court is concerned about the reliability of the indicated value. For example, only two properties submitted by plaintiff, CP Nos. 5 and 6, were located on acreage of comparable size to plaintiff's property, 8.52 acres. Many of the sales selected as comparable properties were located miles away from the subject property. Plaintiff's CP No. 4 stated that the buyer would receive a tax exemption when 11 of the units were rented at reduced rates to tenants who are at or below 60 percent of the income median in the Portland area. Both parties used this sale as a comparable but failed to explain the impact, if any, of the tax exemption on the sales price. Many of the comparable properties included amenities such as a pool, tennis courts, recreation rooms, covered parking and garages. These amenities would increase the owner's expenses. Plaintiff attempted to adjust for these differences by an "NOI Ratio"; defendant made no adjustment. In addition, plaintiff's CP Nos. 1, 5 and 6 included credits for various maintenance items, including L/P siding, or completion of the structure. The sales prices were not adjusted for these substantial amounts, e.g., $400,000, $300,000 and $470,000. Failure of either party to consider these numerous items leaves the court with concerns about the reliability of the indicated real market value and leads the court to consider other valuation methods suggested by the parties.

Mr. Taylor placed more weight on his gross income multiplier (GIM) analysis "because it is a more direct link to the market." (Def's Ex at 8 - 9.) In doing so, Mr. Taylor used 3 of plaintiff's 4 comparable sales and one property, N.E. 7th Avenue, which was sold March, 2000. The GIMs ranged from 6.99 to 8.23 with Mr. Taylor concluding that 7.5 was the more "appropriate." *Id.* The GIM multiplied by a gross potential income of $525,500 resulted in an indicated value of approximately $4,000,000 for the 65 apartment units and

$570,150 for the 8 duplex units for a total real market value of $4,570,150 for the subject property.

Mr. Taylor's GIM appears to be on the high end of the range. The GIM Range reported by Norris and Stevens for larger apartment communities (30 - 400 units) built after 1986 for the first nine months of 1998 was 6.3 to 7.5. (Ptf's Ex at 43.) The Barry Apartment Report for the year ended 1998 reported a range of 6.5 to 7.6 for newer garden apartments (post 1985). (Def's Ex at 26.) The GIMs for the two properties, CP Nos. 2 and 5, which plaintiff concluded were the most similar to the subject property were 7.16 and 6.99. (Ptf's Ex at 1.) Plaintiff computed an average GIM, 6.89, based on its 5 comparable sales. (Ptf's Ex at 4.) Using the adjusted rent roll as of December 31, 1999[3], a GIM of 7 would result in an indicated real market value of approximately $4,300,000 for the 73 units.

Plaintiff developed two additional indicators of value, direct capitalization using actual income and proforma income, which the court will discuss. Plaintiff's capitalization rate was the sum of a direct capitalization rate of 8.5 percent and a property tax rate of 1.631 percent. Plaintiff's comparable sales grid computed capitalization rates ranging from 7.13 to 9.15 percent, with CP Nos. 2 and 5 rates being 8.17 percent and 8.64 percent. (Ptf's Ex at 4.) The average capitalization rate based on the 5 comparable sales was 8.4 percent. *Id.* Mr. Taylor selected a capitalization rate of 8 percent which he stated was within the range of 7.13 percent and 8.5 percent for the three comparable sales he used. (Def's Ex at 10.) Mr. Taylor testified that it is important to be consistent when developing a capitalization rate. In his exhibit, Mr. Taylor wrote that the "real estate agent

---

[3]The rent roll for December 31, 1999, is adjusted for unit 315 which was entered twice. The total monthly base rent was $51,563 or $618,756 annually. Because the subject property has a limited rental history, the court considers the latest rent roll to be the most reliable data for this computation.

estimates income and expenses and incorporates these estimates into a kind of sales brochure for the property." (Def's Ex at 12.) The Barry Apartment Report reported a range of 8 percent to 8.9 percent. (Def's Ex at 26.) The Norris and Stevens Apartment Investors Journal listed the Clackamas County range to be 8.0 percent to 9.4 percent. Based on the data presented, the court concludes that the capitalization rate should be 8.4 percent.

The parties disagree as to how to compute the property tax rate. Mr. Taylor concluded that Oregon's enactment of Measure 50 created a problem which can be solved by developing a rate based on the actual taxes paid divided by the real market value of the property as stated on the tax roll. (Def's Ex at 15.) Using Mr. Taylor's method, the property tax rate was $12.65 per thousand of real market value. Plaintiff computed a property tax rate of $16.31 per thousand of assessed value. (Ptf's Ex at 2.) In calculating the property tax rate component, the objective is to determine the effective tax rate in the area of the property to be appraised, specifically the rate of assessment on the real property. *See Valley River Ctr, et al v. Dept. of Rev.*, 6 OTR 370, 373 (1976). Mr. Taylor's rate is below the property tax rate in the area. The court will use plaintiff's property tax rate.

In developing an overall capitalization rate, Mr. Taylor offered the following guidelines. Quoting from The Appraisal of Real Estate, 11th edition, Mr Taylor emphasized that a "*capitalization rate derived from a comparable sale property* **is valid only if it is applied to the subject property on the same basis**." (Emphasis in original.) He testified that because the capitalization rates are developed from estimated income and expenses the overall capitalization rate should be applied to a proforma or estimated income and expenses of the subject property. The court agrees with defendant that the overall capitalization rate should be applied to a proforma net operating income. It is difficult to estimate the expected income for the subject property because it was recently

constructed and contributing economic factors have made it difficult to keep the units filled with tenants. The lack of a stable history of three to five years of operating experience makes it difficult to determine "expected future income." *Valley River Ctr. et al v. Dept. of Rev.*, 6 OTR 370, 372 (1976). However, for the comparative purpose of this capitalization rate analysis, the court will use plaintiff's "capitalization of income into value, proforma" which reported effective gross income after the vacancy and credit loss for the 73 units to be $584,135 based on the 1999 rent charged for the individual unit. (Ptf's Ex at 3; see footnote 3 for an explanation of why the 1999 rent was used). Both plaintiff and defendant agree that the vacancy and credit loss estimate is 6 percent. (Ptf's Ex at 3; Def's Ex at 16.) Plaintiff concluded that the expense estimate should be 30.6 percent whereas defendant used 25 percent. *Id*. Defendant's comparable sales data reported expenses excluding taxes ranging from 24 to 31 percent. (Def's Ex at 11.) In comparison, plaintiff reported a range of 24 to 36 percent. (Ptf's Ex at 17, 20, 26, 29 and 33.) Plaintiff's proforma income estimate with expenses estimated at 30.6 percent and an overall rate of 10.131 percent resulted in an indicated value of $4,000,000 for the 73 units. Defendant used its own proforma income and expense estimates and a lower overall capitalization rate resulting in an indicated value of $4,000,000 for only the 65 apartment units. The court concludes that based on its overall capitalization rate of 10.131 percent and proforma net operating income (after 31 percent operating expense deduction) of $403,000, the indicated value of the subject property was $4,000,000.

In summary, based on the comparable sales, gross income multiplier and direct capitalization methods, the real market value of the 73 units ranged from $3,800,000 to $4,500,000. After carefully considering the various methods with modifications, the court concludes that the real market value of the subject property for the tax year

1999-2000 was $4,100,000.

CONCLUSION

IT IS THE DECISION OF THE COURT that the real market value of the subject property identified by the Clackamas County Assessor as Account Nos. 1813844, 1813853, 1813862, 1813871, 1813880, 1813899, 1813906, 1813915 and 1813924 was $4,100,000 for the tax year 1999-2000.

Dated this _____ day of May, 2001.

JILL A. TANNER
MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97301-2563. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE JILL A. TANNER ON MAY 3, 2001. THE COURT FILED THIS DOCUMENT ON MAY 3, 2001.