IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Property Tax

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| ROSE COURT ASSOCIATES, LTD, | ) | |
| | ) | |
| Plaintiff, | ) | TC-MD 030502C |
| | ) | |
| v. | ) | |
| | ) | |
| JACKSON COUNTY ASSESSOR, | ) | |
| | ) | |
| Defendant. | ) | **DECISION** |

This appeal involves a low income project in Phoenix, Oregon. Plaintiff seeks a reduction in the specially assessed value (SAV), the maximum specially assessed value (MSAV), and assessed value (AV) of the subject property for the 2002-03 tax year. Plaintiff was represented at trial by W. Scott Phinney, Attorney at Law, of Lake Oswego, Oregon. Testifying on behalf of Plaintiff was Mark Skelte (Skelte), an Oregon licensed commercial real estate appraiser with an MAI designation by the Appraisal Institute. Defendant was represented by David Arrasmith (Arrasmith), Jackson County Deputy Assessor, a state registered commercial appraiser.

## I. STATEMENT OF FACTS

The subject property consists of a five-building, 36-unit apartment complex built in 1987. Each of the thirty-six units are of the same size and type. The buildings sit on 2.11 acres located at 1106 Rose Street North, Phoenix, Oregon. (Ptf's Ex 5.)

The property operates under the federal Rural Rental Housing Act, section 515 (section 515), pursuant to a regulatory agreement. (Ptf's Ex 1 at 2.) Information pertaining to the section 515 program was presented to the court in the form of a written narrative prepared by Skelte. Plaintiff did not submit official government documents describing the program, nor did the owner testify as to the operation of the property. Plaintiff did submit the FmHA loan

agreement, executed September 12, 1986, which provides pertinent information concerning Plaintiff's government loan. (Ptf's Ex 9.) From that collection of information the court deduced the following salient facts.

The property was financed with the proceeds of a 50-year mortgage loan, made or insured by the federal government in 1986, with a resulting interest rate of one percent. The owner made an initial equity investment of approximately five percent, which came to $55,630, and received a loan in the amount of $1,056,870. (Ptf's Ex 9 at 1.) Therefore, the cost of the project was approximately $1,112,500. (*Id.*) Section 515 housing provides housing at restricted rents to eligible individuals. Under the contract, rents are governmentally regulated and paid in part by the tenant and in part by the government. Plaintiff must set aside $10,572 per year in a reserve account for capital improvements. Annual payments to the reserve account are fixed until that account reaches the sum of $105,720, with contributions resuming when necessary because of disbursements from the account, to restore it to the sum of $105,720. (Ptf's Ex 9 at 2.) Plaintiff is limited to an annual return of eight percent of its original equity investment, which comes to a dividend of $4,450 per year. That dividend is contingent upon the existence of sufficient income after all required expenses are paid, including debt service and contributions to the reserve account. While the property is subject to the section 515 program, the owner can only sell to approved parties; may not encumber the property; and must consent to government inspection of its records to ensure Plaintiff follows the program's financial requirements.

Pursuant to ORS 308.704,[1] Plaintiff elected to have the property valued in accordance with the provisions of ORS 308.712(1)(a). That statute provides for special assessment of multiunit rental housing subject to government restriction (low income housing) using "actual

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[1] All references to the Oregon Revised Statutes (ORS) are to 2001.

income and stabilized operating expenses * * * and a capitalization rate." ORS 308.712(1)(a). Actual income and stabilized operating expenses are used to arrive at net operating income (NOI). OAR 150-308.712(3)(g).[2] As with any income approach to value, NOI is divided into an overall capitalization rate (overall rate) to arrive at a value, which the statute defines as the SAV. *See* ORS 308.707(2) (providing for an SAV for property an owner elects to have valued under ORS 308.712) and OAR 150-308.712(3)(h)(C) (defining the overall rate).

For the tax year at issue (2002-03), the property was identified in the Jackson County assessor's records as Accounts 1-063384-9 and 1-074866-5. The SAV of the property is set at $393,200 and the MSAV at $322,400. The court allowed the pleadings to be orally amended at trial, as follows: Plaintiff requests that the SAV of the real property be set at $270,000 and that the MSAV be derived in accordance with ORS 308.707(3)(a), by multiplying the SAV by the changed property ratio (CPR). Finally, the AV would be determined in accordance with subsection (4) of ORS 308.707. Real market value (RMV) is not at issue.[3] Defendant requests that the SAV and MSAV be increased to $415,960 and $341,093, respectively. (Def's Ex A.)

Plaintiff's appraiser Skelte originally estimated the SAV of the subject property to be $200,000 after removing $14,400 for the value of the personal property. (Ptf's Ex 1 at 6.) However, at the commencement of trial, Plaintiff informed the court that it was willing to accept Defendant's NOI of $40,243, in order to narrow the scope of the court's inquiry to a determination of the appropriate capitalization rate (cap rate).[4]

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[2] All references to the Oregon Administrative Rules (OAR) are to 2001.

[3] The RMV, which is not in dispute, is $2,069,680. In its Complaint, Plaintiff requested that the RMV and SAV be reduced to $345,000 and that the SAV be multiplied by the CPR to arrive at the AV. Defendant in its Answer requested that the court sustain the RMV, SAV, and AV on the tax roll.

[4] Skelte's original SAV estimate was based on a stabilized NOI of $30,061.

## II. ANALYSIS

The only issue before the court is the appropriate cap rate. The rate is to be set in accordance with the applicable statute and administrative rule. In setting the cap rate, the statute requires consideration of "the risks associated with multiunit rental housing subject to a government restriction on use." ORS 308.712(1)(a). The statute sets forth, by way of example, certain risks to be considered, "including but not limited to diminished ownership control, income generating potential and liquidity." *Id.* Finally, "[t]he capitalization rate that is set pursuant to [ORS 308.712(1)(a)] must be equal to or greater than the capitalization rate used for valuing multiunit rental housing that is not subject to a government restriction on use." *Id.*[5]

The legislature authorized the Department of Revenue (department) to adopt rules to further define the cap rate. *Id.* Pursuant to the legislatively granted prerogative, the department promulgated a rule that echoes the statute, and adds one important additional factor. In developing an overall rate, "the effective property tax rate for the code area where the property is located" is to be added to the "selected" rate. OAR 150-308.712(h). The selected rate is simply the base rate adjusted as necessary for risk.

A. *Base Rate*

Skelte estimated a base rate of 9.25 percent from a collection of sales of conventional properties in the Phoenix area. Skelte analyzed six sales in southern Oregon – two in Medford,

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[5] ORS 308.712(1)(a) provides, in relevant part:

"The income, expenses and capitalization rate used must be consistent with the Uniform Standards of Professional Appraisal Practice and may be further defined by rules adopted by the Department of Revenue. Factors to be considered in setting a capitalization rate include the risks associated with multiunit rental housing subject to a government restriction on use, including but not limited to diminished ownership control, income generating potential and liquidity. The capitalization rate that is set pursuant to this paragraph must be equal to or greater than the capitalization rate used for valuing multiunit rental housing that is not subject to a government restriction on use."

and one each in Central Point, Talent, Phoenix, and Grants Pass. All of the sales were, in Skelte's opinion, arm's length transactions between knowledgeable parties with no undue duress or atypical financing. Skelte found rates of between 7.79 and 9.31 percent. According to his testimony, Skelte "honed in" on sales three through six because of their similar size, and relied most heavily on sale five, involving a 32 unit apartment complex in Phoenix built in 1985. It sold in March 2001, and had a cap rate of 9.26 percent. The subject is a 36 unit complex in Phoenix built in 1987. Skelte specifically selected conventional properties not subject to government restrictions to develop his base rate because, in his opinion, there are no reliable, arm's length sales of restricted properties.

Arrasmith estimated a base rate of 8.44 percent, based on the average rate used by the assessor county-wide in 2002 for tax purposes in assessing all multiunit housing complexes of five or more units. (*See* Def's Ex C at 2.) The data was not limited to sales, and is, therefore, not market based. According to Arrasmith, the appraiser in each case visited the property and, based on his or her appraisal judgment, "assigned" a cap rate for purposes of estimating value for annual tax purposes. The court admitted the exhibit over Plaintiff's objection. However, Plaintiff's concerns are well founded and have been considered by the court in evaluating the evidence. For the reasons set forth below, the court finds Defendant's exhibit, and thus its base rate, unpersuasive because it does not comport with the statute and rule.

The statute requires that a rate be set and that the rate set include consideration of the risks associated with governmentally restricted housing. ORS 308.712(1)(a). The rate so set "must be equal to or greater than the capitalization rate used for valuing multiunit rental housing that is not subject to a government restriction on use." *Id.* The rate must be consistent with the Uniform Standards of Professional Appraisal Practice (USPAP) and the rules adopted by the department. *Id.* The department's rule parallels the statute but clarifies that the selected rate is to

be "equal to or greater than the rate used **by the assessor** for similar unrestricted properties." OAR 150-308.712(h)(B).[6] (Emphasis added.) It is clear from those provisions that the rate selected is not to be the rate used by the assessor for annual assessment purposes involving unrestricted multiunit housing. Rather, as Plaintiff contends, the rate set (or selected) is to be based on standard appraisal methodology, and that rate must be equal to or greater than the rate used by the assessor for the annual assessment of unrestricted property. The tax rate is then added to the selected rate. *Id.*

Plaintiff agues that Defendant's exhibit contravenes existing case law because it relies on assessed values rather than market-derived data and the data used to develop Defendant's cap rate was not submitted into evidence. This court has previously stated that "[t]he capitalization rate developed should be a reflection of general-market realities. Such rates are typically developed either from examination of actual sales and income data or from methods such as the band-of-investment approach." *Wilsonville Heights Assoc., Ltd. v. Dept. of Rev.*, 17 OTR 139, 155 (2003), *citing* Appraisal Institute, *The Appraisal of Real Estate* 531, 534 (12th ed 2001). Skelte's rate was derived from an examination of actual sales; Arrasmith's was not. Nor did Arrasmith employ the band-of-investment approach.

As for the absence of supporting data, in *Domogalla et al v. Dept. of Rev.*, 7 OTR 340 (1978), this court rejected the plaintiff's appraisal, which relied most heavily on the income approach, as "incomplete, inadequate and superficial." *Id.* at 345. The court stated that "[t]he witness's testimony and his written appraisal report are marked by a lack of supporting evidence and detail. [The appraiser] was dependent in large measure on the work of another appraiser

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[6] The 2002 rule provides that "the selected capitalization rate [sic] equal to or greater than the rate used **by the assessor** for similar unrestricted properties." (Emphasis added.) When the rule was amended in 2003, the words "must be" were inserted before the phrase "equal to or greater than."

(who was not present in court) and he was not able to answer questions on the work of the other appraiser." *Id* at 345-346. The court later stated: "[t]he court can only be persuaded by those conclusions of value which appear to be well supported and reasoned. This witness failed to provide substantial supporting data and significant steps in his reasoning were left unexplained." *Id*. at 348. Here, neither appraiser supplied supporting data. Both were generally able to explain their reasoning, but Arrasmith operated under a misunderstanding of the governing statute and rule; consequently, he simply averaged all rates used. Many of those rates were "assigned" by other appraisers, based on criteria Arrasmith could not explain. In contrast, Skelte relied on market transactions.

Skelte's evidence has its shortcomings. Five of Skelte's six sales post-date the January 1, 2002, assessment date, and two are much larger complexes. However, they are all located in the vicinity of the subject and post-assessment date transactions can be used as a check on value. *Sabin v. Dept. of Rev.,* 270 Or 422, 427-428, n11, 528 P2d 69 (1974); *Truitt Brothers, Inc. v. Dept. of Rev.,* 10 OTR 111, 115-116 (1985), *aff'd* 302 Or 603, 732 P2d 497 (1987). Skelte reported a range of rates between 7.79 and 9.31 percent and selected a rate at the upper end of his range (9.25). That rate was essentially identical to the rate for Skelte's best comparable, which had a rate of 9.26 percent. That comparable, discussed above, is similar in age and size (number of units) and is located in the same town as the subject. Based on a preponderance of the evidence standard set out in ORS 305.427, the court finds Skelte's base rate of 9.25 percent persuasive.

B. *Risk*

The next question is whether there should be an adjustment to the cap rate to reflect "the risks associated with multiunit rental housing subject to a government restriction on use" and, if so, what that adjustment should be. ORS 308.712(1)(a). It is important to note that the statute

does not require an adjustment for risk. Rather, it requires **consideration** of risk factors, "including but not limited to diminished ownership control, income generating potential and liquidity." *Id*.[7]

Skelte has worked as a real estate appraiser since 1987 and has been actively involved in low income housing valuation work since the late 1980s. Skelte testified that 30 to 50 percent of his work in any year is related to low income housing valuation. Skelte is familiar with the section 515 program, as well as other low income housing programs. Skelte testified that the section 515 rural development program is an extremely constrictive program, giving the owner limited control of the property, as explained in Plaintiff's Exhibit 2. As a result, Skelte believes the cap rate needs to be adjusted to reflect the additional risk.

In his report, Skelte states that the lack of control by the owner encompasses "management [and] disposition" of the property, as well as "decisions concerning profitability and cash flow distribution." (Ptf's Ex 2 at 3.) Specifically, rents are controlled by the government and can only be increased with government approval; the owner is required to make annual payments to a reserve account regardless of cash flow; and the owner's return is limited to eight percent of initial investment. Moreover, that dividend is contingent upon the availability of funds after payment of all expenses, including payments to the reserve account and the owner's annual debt service. The maximum possible dividend in this case is $4,450 per year. Additionally, the owner cannot sell, lease, encumber, or give the property away without government approval. Furthermore, Skelte contends that administrative, accounting and legal costs are typically higher to ensure compliance with the rural development program, and

[7] The statute provides, in relevant part: "[f]actors to be considered in setting a capitalization rate include the risks associated with multiunit rental housing subject to a government restriction on use, including but not limited to diminished ownership control, income generating potential and liquidity. ORS 308.712(1)(a).

maintenance costs are higher due to greater turnover and lower quality construction. (Ptf's Ex 2 at 4.) In light of those restrictions, Skelte testified that the loss of control to the owner under the section 515 program is much greater than 50 percent. When pressed on cross examination, Skelte testified the government's control was closer to 100 percent.

Skelte analogizes the sale of a governmentally restricted housing project like the subject property to the sale of a partial interest in real estate, because in both cases no single individual is in charge of all operational decisions. Skelte analyzed nine partial interest sales, and found discounts ranging from a low of 5.9 percent to a high of 84 percent. (Ptf's Ex 2 at 9-10.) Skelte noted the higher discounts involved vacant speculative land acquisitions that are inapplicable to the analysis of the subject property. As a result, Skelte excluded sales four and five, narrowing the discount range to between roughly 6 and 50 percent. Skelte found that the sale of smaller interests had higher discounts. Skelte testified that he found acquisitions of 20 to 50 percent interests receiving 20 to 40 percent discounts, and from that analysis concluded a 35 percent discount was applicable to a rural development section 515 property. Accordingly, Skelte applied a 35 percent discount to the subject property. Skelte testified that his conclusion was supported by discussions with buyers of such interests over time. Skelte applied the discount by multiplying the base rate of 9.25 percent (.0925) by 1.35, to arrive at a combined rate (the "selected" rate) of 12.49 (.124875).

Arrasmith looked at three sales of section 515 properties that occurred in 1993 to determine if there was an additional risk component to be added to the base cap rate. His theory is that if cap rates from restricted property sales are below the rates for unrestricted

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properties, there is no risk, because risk is ultimately reflected in the cap rate. In calculating a cap rate from those sales, Arrasmith had to calculate NOI, because he only knew the sale price.[8] Arrasmith used total mortgage payments as NOI for the two acquisitions by nonprofits, and a combination of mortgage payments and the owner's equity dividend for the third sale involving a for-profit buyer. He did so because, under the section 515 program, funds remaining after paying expenses and funding the reserve can only be used to pay the mortgage and the owner's dividend.[9] Arrasmith relied on the definition of "capitalization value" established by the federal government for rural development properties, which is explained in a form titled "RD Instruction 1922-B." (*See* Def's Ex H at 9.) That instruction lays out the approach to be used by an appraiser valuing rural development property. It states that value is "based on enabling the income stream to support the annual debt service, operating and maintenance (O&M) expenses, funding the reserve and giving a return to the owner in a specified time-frame." (*Id.*) Arrasmith assumes that approach was used by the appraisers in determining the sale price for each of the three properties, and notes that appraisers valuing rural development property are to determine NOI based on actual contract rents under the program. (Def's Ex H at 15.) Operating on that assumption, and based on repeated claims that income after expenses is often insufficient to fund the owner's contingent equity dividend, Arrasmith concluded that NOI would equate to annual debt service (plus the for-profit owner's return on investment) each year, and no more. (*See* Def's Exs J, K, and L.)

Arrasmith's three restricted sales are generally in the vicinity of the subject property. The indicated cap rates are 8.28 percent, 7.94 percent, and 8.42 percent. Because all of those rates are

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[8] NOI ÷ sale price = cap rate.

[9] According to the testimony, Arrasmith found it easier to calculate "what NOI had to cover" than to estimate income and expenses.

below his base rate of 8.44 percent, Arrasmith concluded there was no risk involved in owning and operating the subject property. Those rates are also below Skelte's base rate of 9.25 percent.

The court has concerns with the evidence from both parties. Of course, Plaintiff bears the burden of proof because it is the party seeking affirmative relief. *See* ORS 305.427. Under the statute, "a preponderance of the evidence shall suffice to sustain the burden of proof." *Id*. This court has previously accepted Skelte's use of partial interest sales as a measure of risk associated with low income housing properties due to a lack of control. *See Chief Tyee LLC v. Jackson County Assessor*, TC-MD 030459C, WL 438577 at * 8 (Mar 1, 2004). However, here, Arrasmith brought out certain shortcomings in Skelte's evidence on cross-examination. Skelte's partial interest transactions occurred in the early to mid-1990s. Skelte is not certain whether the sales were offered to the general public, whether they were between related parties, or whether there were other extenuating circumstances such as the death or divorce of the owner that impacted the seller's motives. Moreover, Skelte did not verify the percentage of ownership interest, but relied instead on the information from the parties, and he relied on the opinion of the buyer or seller as to the amount of the discount they believe was given. Skelte testified that in confirming his partial interest transactions, he was looking to find what the buyer felt they negotiated, in the form of a discount, for buying less than a 100 percent interest – he looked for the "perceived" level of discount. Arrasmith further noted that many of the properties are located in Washington. All those factors, particularly the fact that the discount was estimated, trouble the court.

Plaintiff argued in closing that Skelte's partial interest sales were not used to develop the base cap rate, and it was therefore not important for the appraiser to investigate income, expenses, cap rate, and other factors. Rather, Skelte sought the buyer's perception of the effect on market value of acquiring a minority interest. The court understands the intended purpose of

the exhibit. However, because the sales were used as an indication of the effect on market value of acquiring a minority interest, it was incumbent upon the appraiser to verify the terms and conditions surrounding each sale to determine whether they reflected the collective opinion of the market, whether there was undue motivation, and, most importantly, whether the buyer's perception of the discount achieved was accurate. It is part of human nature for a buyer to believe they got a fair price, or a better-than-fair price – a discount. An error in perception could change the result significantly.

The court notes the following additional concerns. One of Skelte's nine partial interest "sales" involves several "attempted partial interest transactions" rather than consummated deals (sale 3), and two others (sales 4 and 5) involve unimproved land. (*See* Ptf's Ex 2 at 10.) Skelte excludes the unimproved sales from further consideration and the court rejects the third "sale." Of the remaining six, three (sales 7, 8, and 9) involve different types of property (office, commercial, and industrial) located in Seattle and Portland. The court has concerns with the lack of comparability. Different types of property involve different levels of risk and the additional "risk" associated with buying a partial interest would be impacted by the underlying risk. That leaves three sales of apartment complexes. Sale one involved the acquisition of a 6.56 percent interest with a reported discount of 49.8 percent. Sale two involved a 50 percent interest and a 5.9 percent discount. Finally, sale six involved an interest of "under 50%" and a discount of approximately 20 percent. Assuming the reported discounts are accurate, the range is between 7 and 50 percent, with the discount reduced significantly (to approximately 6 percent) for a full one-half ownership interest. (*Id.*)

Skelte considers the government's control to be between 50 and 100 percent, meaning that the owner's interest (control) is between zero and 50 percent. Recapping the restrictions, the owner cannot raise the rent or sell the property without federal government approval, must fund

the reserve account before taking a profit, and receives a nominal contingent equity dividend, which in this case can be no more than $4,450 per year on a 15-year old investment of approximately $55,000. However, Arrasmith's evidence shows that rural development properties do sell and that a buyer can negotiate for an increase in rent and dividend.[10] Additionally, removing book depreciation from expenses shows there are sufficient revenues to pay the owner's dividend.

Turning to Arrasmith's evidence, Plaintiff argues that the three restricted sales were atypical and not true arm's length market transactions free of undue influences or motivations, and that Arrasmith's methodology in deriving a cap rate is flawed because NOI was determined by using annual debt service rather than estimated of income and expenses. The sales are atypical, asserts Plaintiff, because the buyer obtained nearly 100 percent financing and two of the three purchasers were nonprofit organizations that are in the business of providing low income housing. The court shares those concerns, which were not addressed by Arrasmith. As for the determination of NOI, Arrasmith testified that he found it easier to calculate what "NOI had to cover" based on the "budgeting process they go through" than to go through the typical process of estimating income and expenses. That is no doubt true, but it does not validate Arrasmith's approach.

Although the court is intrigued with Arrasmith's methodology, it nonetheless has concerns. For example, it is unclear to the court whether the above-the-line expenses include depreciation and/or property taxes. If so, those items would have to be removed and added to NOI, which would have the effect of increasing NOI and thereby increasing the cap rate.

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[10] Arrasmith reports the sale of three section 515 properties. (Def's Exs J, K, and L). Skelte testified on redirect that the buyer of the Gold Beach Apartments (Def's Ex K) negotiated with rural development for an increase in rents and the dividend.

Moreover, if the court is interpreting the evidence correctly, the NOI for the subject property, using Arrasmith's approach, would be at least $90,000 (based on total mortgage payments and Plaintiff's dividend), yet Defendant calculates the subject's NOI under the more traditional methodology to be only $40,243.[11] The numbers simply did not add up. And, assuming the validity of Arrasmith's approach to determining NOI, only one of the three sales – the Gold Beach Apartments – appears to be a true arm's length transaction between equally motivated participants unaffected by undue considerations, and Arrasmith erred in his cap rate calculation. Arrasmith divided his NOI by the contract sale price, but the buyers reported that they paid a $50,000 premium because of the favorable government interest rate. Arrasmith's cap rate goes up from 7.94 percent to 9.6 percent with the adjustment to the sale price, suggesting a risk of approximately 14 percent when compared to Arrasmith's base rate of 8.44 percent, and a risk of approximately 4 percent measured against Skelte's base rate of 9.25 percent.[12]

To recap the parties' positions, Plaintiff's appraiser (Skelte) believed the discount range was between 20 and 40 percent and that the appropriate risk adjustment for the subject property was 35 percent. Arrasmith found lower cap rates for sales of restricted properties compared to unrestricted properties, and Defendant therefore asserts no adjustment for risk is warranted. Given the court's concerns and analysis of the evidence presented by both parties, the court concludes that a risk adjustment of 20 percent is appropriate. The selected rate is therefore 11.1 percent (.1110)[13]

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[11] The parties' exhibits show approximately $86,000 in annual mortgage interest for the subject. (*See* Ptf's Exs 10 and 11; Def's Ex B.)

[12] .096 ÷ .0844 = 1.137 = 13.7 percent; .096 ÷ .0925 = 1.038 = 3.8 percent.

[13] .0925 (base rate) x 1.2 (20 percent risk) = 0.11100.

C. *Tax Rate*

The administrative rule provides for a tax component to be added to the selected cap rate. Specifically, the rule provides:

> "[t]o the selected rate, add the effective property tax rate for the code area where the property is located. This is the overall rate to use for capitalization."

OAR 150-308.712(2)(h)(C).

The rule does not define the term "effective property tax rate." Plaintiff used the actual tax rate of 0.016 (based on the reported millage rate for the code area of $16 per $1000 AV). Defendant calculated an "effective property tax rate" by dividing the actual property taxes for the subject by the MAV[14] to derive a "nominal rate," and then multiplied that rate by the 2001 changed property ratio (CPR)[15] to arrive at an effective tax rate of 0.01234.

Defendant submitted definitions for the term "effective tax rate" from two respected sources. (*See* Def's Ex D at 16.) Those sources reveal that the effective tax rate is determined by

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[14] The concept of maximum assessed value (MAV) was established by voter approved referendum Measure 50, which amended Oregon's constitution for the tax year beginning July 1, 1997 (1997-98 tax year). Or Const, Art XI, § 11. Measure 50 imposed a maximum assessed value (MAV) on each property, initially (1997-98 tax year) set at 90 percent of the property's 1995 RMV. *Id.* at § 11(1)(a). For tax years after 1997-98, MAV increases by no more than 3 percent. *See id.* at § 11(1)(b) (limiting the increase in MAV for tax years beginning after July 1, 1997, to no more than three percent); ORS 308.146(1) (providing for an MAV that is the greater of 103 percent of the property's AV from the prior year or 100 percent of the property's MAV from the prior year). Taxes are applied to AV, and AV is the lesser of MAV or RMV.

[15] The CPR in Oregon is the "ratio of average maximum assessed value over average real market value" for the property class. OAR 150-308.156(1).

multiplying the "official" tax rate (or the "nominal" tax rate) by the "assessment ratio."[16] The official rate and the nominal rate are synonymous.[17] Thus, the effective tax rate is the official (nominal) tax rate multiplied by the assessment ratio. The term "assessment ratio" is defined as "the relationship between assessed value and market value." Appraisal Institute, *The Dictionary of Real Estate Appraisal* 22.

Plaintiff erred in using the actual tax rate as the effective tax rate. The two rates are not the same. If the department meant for the actual tax rate to be added to the selected cap rate, it would have said that. It did not. The court concludes that in drafting the rule, the department intended the effective tax rate to be determined consistent with accepted definitions in the field of property appraisal and assessment administration. Plaintiff's approach conflicts with the administrative rule and must be rejected by the court.

Defendant came close in its approach to deriving an effective rate, because it calculated the correct nominal rate, and Defendant multiplied the nominal rate by a ratio. However, there are problems with both components of Defendant's calculation. First, Defendant's methodology will not always produce a true nominal rate, because Defendant divided the taxes for the subject property by the MAV. In Oregon, taxes are applied to AV and AV is the lesser of RMV or MAV. ORS 308.146(2). Thus, where AV is based on RMV rather than MAV (because RMV is

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[16] One source defines the effective tax rate as "[t]he **official** tax rate times the assessment ratio." Appraisal Institute, *The Dictionary of Real Estate Appraisal* 113 (3rd ed 1993) (emphasis added). The other source provides for the calculation of an effective tax rate "by multiplying the **nominal** tax rate by the assessment ratio." The International Association of Assessing Officers (IAAO), *Property Appraisal and Assessment Administration* 15 (1st ed 1990) (emphasis added).

[17] The "[official] tax rate" is "obtained by dividing the amount of the tax levy by the total assessed value of all properties in the tax district [and is] usually expressed in dollars per $100 or $1,000 (mills) of assessed value." Appraisal Institute, *The Dictionary of Real Estate Appraisal* 363. The nominal tax rate is defined as "the relationship between the tax levy and the total assessment for the jurisdiction: the levy amount is divided by the assessment amount to give the nominal tax rate." IAAO, *Property Appraisal and Assessment Administration* 15. As can be seen, the definitions are synonymous.

less than MAV), Defendant's methodology will not yield the nominal rate. Moreover, in requiring the addition of "the" effective tax rate for the code area, the rule contemplates the use of a single rate, and Defendant's approach (of dividing MAV by RMV) will yield a different rate for different properties, thereby violating the rule. Defendant's approach worked in this case because Plaintiff's AV is based on MAV, but the method is nonetheless flawed. The correct approach (using the official tax rate) will yield a single rate for the code area, as required by the rule, and will eliminate a step in the calculation, because the official (nominal) rate is already calculated.

The second problem with Defendant's approach is its failure to use a true "assessment ratio."[18] Defendant multiplied its nominal rate by the CPR. Use of the CPR as an assessment ratio has the appeal of simplicity because the CPR is calculated each year to implement Measure 50. However, the CPR is the ratio of MAV to RMV, whereas the assessment ratio is the ratio of AV to RMV.[19] As explained above, in Oregon, MAV and AV are not always the same because AV is the lesser of RMV or MAV. *See* ORS 308.146(2). Instead of relying on the CPR, Defendant must divide the AV for the code area where the property is located by the RMV for the applicable code area. That yields an assessment ratio.

The final question is which year's AV and RMV should be used in calculating the assessment ratio. The court concludes that the 2001-02 tax year values are to be used because the values for the 2002-03 tax year were not known at the time Plaintiff, or any other taxpayer, applied for special assessment in 2002. Defendant must then multiply the resulting assessment

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[18] Plaintiff's approach is more fundamentally flawed because it did not use any ratio.

[19] See footnote 15 above for the definition of the CPR.

ratio by the "official tax rate" for the code area to arrive at the effective tax rate for the code area. That rate, in turn, must be added to the selected cap rate of 11.1 percent.

To summarize, the assessment ratio must be derived by dividing AV by RMV. And, because the goal of the rule is to determine the effective tax rate for the code area where the property is located, calculation of the assessment ratio must be based on the AV and RMV for the code area where the subject property is located. Multiplying the official rate by the resulting assessment ratio will produce the effective property tax rate for the code area.

In determining what tax rate component to add to the selected cap rate, this court has in the past accepted the approach taken by Plaintiff and rejected Defendant's approach, primarily because Defendant previously was unable to defend its approach. *See Butte Creek v. Jackson County Assessor*, TC-MD 030458D (Jan 27, 2004);[20] *Chief Tyee*, TC-MD 030459C, 2004 WL 438577 at * 10. However, Defendant in the instant appeal has presented a more thorough case, and the court concludes that a different result is in order.

D. *Reconciliation - SAV and MSAV*

By statute, the SAV is the capitalized NOI. The court cannot determine the SAV because it does not have all the necessary information to calculate the cap rate. Specifically, and as indicated above, the court is missing certain information necessary to calculate the effective property tax rate for the code area. However, once Defendant divides the AV for the code area by the RMV for the code area to establish the assessment ratio, and then multiplies that ratio by the official tax rate for the code area, it will have an effective tax rate, which can then be added to the selected rate of 11.1 percent. That rate must then be divided into the stipulated NOI of $40,243 to arrive at an SAV for the subject property.

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[20] A Corrected Decision was issued February 3, 2004 to correct an erroneously labeled value. *Butte Creek v. Jackson County Assessor*, TC-MD 030458D (Feb 3, 2004).

The next question is whether an adjustment need be made to remove the value of the personal property. The rule provides two distinct methods for removing the value of the personal property. *See* OAR 150-308.712(3)(a). If NOI includes revenue and expenses from both the real and personal property, the value of the personal property is deducted from the capitalized NOI. *Id.* Alternatively, income and expenses generated by the personal property can be removed from the data used to calculate NOI, to derive NOI for the real property only. The parties in this case stipulated to Defendant's NOI, and Defendant does not appear to have removed personal property income and expenses from its NOI calculation. (*See* Def's Exs A at 3 and B.)[21] Defendant must therefore remove the value of the personal property which, according to Plaintiff, was valued by Defendant at $14,400. The adjustment shall be made based on the roll value for the 2002-03 tax year.

The final issue is the MSAV. The tax year at issue (2002-03) is the first year for which the subject property is being assessed under the special assessment provisions found in ORS 308.701 to ORS 308.724. Therefore, the MSAV for the subject property will be determined by multiplying the SAV, determined in accordance with the principles set forth above, including the removal of the value of the personal property, by the applicable CPR for

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[21] The profit and loss sheets in Defendant's Exhibit B include revenue from"laundry & vending" and expenses associated with "appliances."

property in the same area and property class. *See* ORS 308.707(3)(a);[22] *see also* OAR 150-308.712(6) (providing that "[f]or the initial year of application, the maximum assessed value of the specially assessed property (MSAV) is found by multiplying the specially assessed value determined using the method chosen by the property owner by the * * * CPR. The assessor must use the same CPR that is used for similar unrestricted multiunit housing."). For the sake of consistency, the 2001-02 CPR shall be used.

E. *Costs and Fees*

Plaintiff's request for an award for appraisal fees and other costs is denied because only the judge of the Tax Court may grant such an award. See ORS 305.490(4). Tax Court magistrates may not award costs under the statute.

## III. CONCLUSION

The court's task was to determine the SAV and MSAV for the subject property for the 2002-03 tax year under the provisions of ORS 308.701 to ORS 308.724. The parties stipulated to a NOI of $40,243. The court has carefully reviewed the evidence and has concluded that the selected cap rate is 11.1 percent. The effective tax rate for the code area must be added to the selected cap rate. Defendant must calculate the effective tax rate by dividing AV for the code area by RMV for the code area to determine the assessment ratio for the code area. Defendant will use the 2001 values for that calculation. Defendant must then multiply the actual tax rate

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[22] The statute provides:

"For the first tax year for which property is assessed under this section, the maximum assessed value of property subject to special assessment under this section shall equal the product of the specially assessed value of the property under subsection (2) of this section multiplied by the ratio, not greater than 1.00, of the average maximum assessed value to the average real market value of property in the same area and property class as the specially assessed property."

ORS 308.707(3)(a).

(millage rate) by the resulting assessment ratio to derive the effective tax rate. Defendant must then add the effective tax rate so computed to the selected rate of 11.1 percent to derive an overall cap rate. The overall rate, when divided into the stipulated NOI, will yield the SAV for the subject property, real and personal. Defendant must subtract the tax roll value of the personal property from the combined SAV to derive the SAV for the real property. The MSAV must then be calculated by multiplying the resulting SAV (for the real property only) by the tax year 2001-02 CPR for property in the same area and property class, as required by ORS 308.707(3)(a). Finally, Plaintiff's request for costs, including appraisal fees, is denied. Now, therefore,

IT IS THE DECISION OF THIS COURT that Defendant shall recalculate SAV and MSAV in accordance with the court's ruling in this matter.

Dated this _____ day of March 2005.

________________________________
DAN ROBINSON
MAGISTRATE

***If you want to appeal this Decision, file a Complaint in the Regular Division of the Oregon Tax Court, by mailing to: 1163 State Street, Salem, OR 97301-2563; or by hand delivery to: Fourth Floor, 1241 State Street, Salem, OR.***

***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 Dan Robinson March 10, 2005. The court filed and entered this document March 10, 2005.**