

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Property Tax

ELECTRO SCIENTIFIC INDUSTRIES, INC.,)	
)	
Plaintiff,)	TC-MD 040165E
)	
v.)	
)	
DEPARTMENT OF REVENUE,)	
State of Oregon, and)	
WASHINGTON COUNTY ASSESSOR,)	
)	
Defendants.)	DECISION

Plaintiff appeals the 2003-04 real market value (RMV) of the property identified in Accounts R633336, P852848, R633345, and R633327.¹ Trial in the matter was held in the courtroom of the Oregon Tax Court, Salem, Oregon. David L. Canary and Cynthia M. Fraser, Attorneys, appeared on behalf of Plaintiff. Christopher A. Gilmore, Assistant County Counsel, appeared on behalf of Defendant Washington County Assessor (Defendant).²

I. STATEMENT OF FACTS

Electro Scientific Industries, Inc. (ESI) is an international business that manufactures and distributes highly technical electronic equipment to the global electronics market. ESI is the leading supplier in advanced laser systems. Its corporate headquarters is located in Washington County and is the subject of this dispute. The property is located on three tax lots totaling 14.67 acres just north of Highway 26. Buildings 1 and 4 are located on Tax Lot 200, which has 5.09

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¹ On July 29, 2005, the parties filed agreements stipulating to the real market value of the machinery and equipment in Accounts R633345 and R633327, and to the real market value of the personal property in Account P852848.

² Defendant Department of Revenue concluded its participation in the case after filing the agreements on July 29, 2005.

acres. Buildings 1 and 4 are connected by an enclosed breezeway. Building 2 is located on Tax Lot 300, which has 4.89 acres, and Building 3 is located on Tax Lot 400, which has 4.69 acres.

Building 1 is a single story building constructed in 1963 with 21,218 square feet. (Ptf's Ex 1 at 24.) It was designed for administrative offices, research and development, and minor manufacturing. Prior to the assessment date, the building was used by ESI as its service center for customer training. The building has its original mechanical systems, which are over 40 years old, with many tubes and pipes that are rusting and leaking. Due to the age of the building and the downturn in the economy, ESI decided to vacate Building 1. As of the assessment date, January 1, 2003, ESI had vacated 50 percent of the building, and by February 2003 it was completely vacated.

Building 4 is a two-story building with a daylight basement. It has 60,960 square feet³ and serves as the administrative headquarters for the entire campus. Some research and development occurs in Building 4 as well as storage in the basement.

Building 2 is located on Tax Lot 300, which is in the center of the campus. It is a two-story building with 105,126 square feet.⁴ The center of the building was built in 1965 as a warehouse. (Ptf's Ex 1 at 25.) An east and west wing were added in the 1980s. (*Id.*) The main floor of the building is designed for manufacturing and laboratory use and has 54,286 square feet. (*Id.* at 26.) Because it was built for manufacturing, it has minimal exterior windows. The main floor has substantial partitioning and intensive build out for ESI's specific manufacturing needs.

³ On page 24 of Exhibit 1, Plaintiff sets forth the gross building area for Building 4 at 60,960 square feet. On page 25 of Exhibit 1, Plaintiff states that Building 4 has 62,585 square feet of gross building area. Defendant claims Building 4 has 61,820 square feet. (Def's Ex A at 6.)

⁴ Plaintiff claims Building 2 has a total of 105,126 square feet of net rentable area and 106,244 square feet of gross building area. (Ptf's Ex 1 at 25-26.) Defendant claims Building 2 has 108,631 square feet. (Def's Ex B at 5.)

In particular, it has one or two clean rooms and approximately 50 laser stalls.⁵ A laser stall is a boxed room where researchers test inventory. Laser stalls have heavy electrical requirements for heating and ventilation and no windows. Building 2 is where most of the manufacturing and assembling takes place for ESI.

The second level of Building 2 has 50,840 square feet and was built as an interior mezzanine. It is used primarily as low quality office space. The second level has a live load capacity of 50 pounds per square foot, whereas 120 pounds is more typical. The lower live load limit restricts heavier uses on the second level. (Ptf's Ex 1 at 26.)

Building 3 is located on Tax Lot 400. It is a single story building built in 1974 with 49,953 square feet.⁶ The building has laser stalls and is used as a machine shop, stockroom and warehouse with a loading dock located in the rear of the building. A daycare facility and cafeteria located in Building 3 serve the entire campus. ESI sold Tax Lot 400 in 1993 to another business and reacquired it in 1997. (Def's Ex C at 12.)

Because the parcels operate as a campus, there are many interconnected systems between the lots. There is an interconnected cooling system between Buildings 1, 2, and 3. (Ptf's Ex 1 at 24.) The phone switch is located in Building 1 and runs underground to the remaining buildings, and the drainage system for the three parcels is a shared, private system. Klepel testified that the intellectual technology for the campus is located in Building 2 and runs underground to the other buildings. Air and vacuum is located behind Building 2 and runs from Building 2 to Building 1, then to Building 4, then underground to Building 3.

⁵ Plaintiff's appraisal states that Building 2 has one clean room and 50 laser stalls. (Ptf's Ex 1 at 26.) Daniel Klepel, the Corporate Facilities Manager for ESI, testified Building 2 had two clean rooms with 50-60 laser stalls.

⁶ Plaintiff's appraisal states that Building 3 has 49,953 square feet, (Ptf's Ex 1 at 24, 27), whereas Defendant's appraisal states it has 49,750 square feet, (Def's Ex C at 5.)

Access to the properties is off of Northwest Science Park Drive. (Ptf's Ex 1 at 30.) An aerial map of the properties shows four access points into the properties. (Ptf's Ex 2.) The first is on the far east to Buildings 1 and 4, although it is not clear this is a frequently used access. The second is a shared driveway between Building 2 and Buildings 1 and 4, although it appears it is used primarily as access for Buildings 1 and 4. The third is located on the easterly portion of Tax Lot 400 for Building 3, although it appears on the map it is the primary access for Building 2 as well. Finally, the fourth driveway is on the west end of Tax Lot 400 and serves Building 3.

Parking on the properties is located throughout the three lots. Buildings 1 and 4 have 243 parking spaces which, according to Plaintiff, equates to a parking ratio of 3.00 spaces per 1,000 square feet.⁷ (Ptf's Ex 1 at 27-28.) Building 2 has 202 parking spaces with a parking ratio of 1.92 spaces per 1,000 square feet.⁸ (*Id.* at 28.) Building 3 has 214 assigned parking spaces with a parking ratio of 4.28 spaces per 1,000 square feet.⁹ (*Id.*)

The properties are zoned for industrial use and are located in an industrial district (IND), which provides:

“The intent and purpose of this District is to provide sites for all types of industrial uses, to provide for the recognition and regulation of existing industrial sites and to provide the regulatory framework for future industrial development, as well as to allow some commercial, office and service uses as accessory uses through mixed use developments where all uses conform to the environmental performance standards of Section 423.”

(Ptf's Ex 1 at Addenda; Ptf's Ex 3 at 1.)

In the late 1990s into early 2001, the high tech market was strong and experienced substantial growth and activity. However, after the “dot com” fallout in mid 2001 and the

⁷ Defendant's appraisal states Buildings 1 and 4 have 242 parking spaces. (Def's Ex A at 1.)

⁸ Defendant's appraisal states Building 2 has approximately 208 parking spaces. (Def's Ex B at 16.)

⁹ Defendant's appraisal states Building 3 has approximately 211 parking spaces. (Def's Ex C at 16.)

economic downturn following September 11, 2001, the market for high tech products dropped significantly. Because of the economic downturn, ESI shut down much of its manufacturing. According to Mark Montgomery (Montgomery), ESI's Tax Manager, ESI is operating at 27 percent of its capacity and stock prices have dropped significantly. Montgomery testified that, in 2001, ESI experienced sales of approximately \$470 million. In 2002, sales dropped to \$162 million (with a \$38 million operating loss), and in 2003, sales dropped to \$135 million (with an \$82 million operating loss).

Each party presented valuation appraisals to the court to support their opinion of value. However, each party differed in its approach to valuing the parcels. ESI's appraisers determined the properties had a highest and best use (HBU) as a campus and valued the lots and buildings as one integrated property. ESI relied primarily on the sales comparison approach to value and arrived at a recommended value of \$11,200,000 for the three lots and four buildings.

(Ptf's Ex 1 at 62.)

Defendant approached the task differently and determined each lot had a HBU as a stand-alone parcel and, therefore, valued the lots independent of one another. For Tax Lot 200, with Buildings 1 and 4, Defendant relied primarily on the income approach to value and arrived at a recommended real market value of \$8,470,800. (Def's Ex A at 29.) For Tax Lot 300, with Building 2, Defendant relied on both the income and sales comparison approaches to value to arrive at a recommended value of \$11,000,000. (Def's Ex B at 36-37.) Finally, for Tax Lot 400, with Building 3, Defendant relied on both the income and sales comparison approaches to value to arrive at a recommended value of \$5,700,000. (Def's Ex C at 34-35.) Adding the three values together, Defendant assigned a total value to ESI's properties of \$25,170,800.

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II. MOTION IN LIMINE

Two days prior to the start of trial, Defendant submitted Defendant's Motion in Limine to Exclude All Appraisal Evidence That Combines Contiguous Tax Lots Together For Purposes of Valuation Analysis (Motion in Limine). Because Plaintiff had no opportunity to prepare a response and the court had insufficient time to consider the matter, the court proceeded with the trial and informed the parties it would consider Defendant's Motion in Limine in its ruling.

Defendant claims Plaintiff cannot value the property as an integrated campus but, instead, must value each tax lot on a stand-alone basis independent of common ownership. Defendant refers the court to *Neupert v. Dept. of Rev.*, 13 OTR 407 (1995) and *First Interstate Bank v. Dept. of Rev.*, 306 Or 450, 760 P2d 880 (1988) to support its Motion in Limine. Because Plaintiff considered the common ownership in its valuation analysis, Defendant claims the court must disregard, in its totality, Plaintiff's appraisal exhibit, citing *Krummenacker/Zimmerling v. Dept. of Rev. (Krummenacker)*, 17 OTR 164 (2003). Plaintiff responded at trial that, when valuing property, the first task is to consider the property's HBU. Once that occurs, the next step is to value the property according to its HBU. Plaintiff claims that, to accurately value the property, its HBU must be considered and its HBU is as a combined campus.

In *First Interstate Bank*, the Oregon Supreme Court discussed Oregon's statutory scheme for describing and assessing real property. The court concluded that the statutory scheme requires the value of each lot be separately assessed and that "[t]he value of each lot by itself, not as a portion of a larger piece of property," be assessed. *First Interstate Bank*, 306 Or at 453. In *Neupert*, the Oregon Tax Court followed the lead of the *First Interstate Bank* decision. In *Neupert*, the property in dispute was a narrow strip of land. The owners of the strip of land owned a contiguous parcel. The government appraiser determined that the HBU of the strip of

land was as part of the contiguously owned lot. The taxpayers claimed the government could not consider the common ownership but, instead, must value the property on a stand-alone basis. The court in *Neupert* agreed with the taxpayers finding “the assessor must establish a separate real market value for each parcel on a stand-alone basis.” *Neupert*, 13 OTR at 411. The court noted that even though the contiguous parcels may enjoy the same ownership, those parcels cannot be combined for purposes of valuation. The court concluded:

“Consequently, the assessor considers the ownership of land only at the description stage, not at the assessment stage. Once a parcel is identified and described for separate assessment, ownership becomes irrelevant for purposes of its valuation. *First Interstate Bank v. Dept. of Rev.*, 306 Or 450, 760 P2d 880 (1988). ‘No useful purpose could be served by separate descriptions if the parcels, though separately described, were to be grouped in valuation.’ Clark A. Nichols, *Cooley-The Law of Taxation* 2169 (4th ed 1924).”

Id. at 411-12.

Plaintiff contends that, notwithstanding, the HBU must first be considered. In *First Interstate Bank*, the Supreme Court appeared to leave the door open on that question when it stated: “It is possible that in certain situations, the highest and best use of a lot would be a part of a group of lots. If that were the case, it would be appropriate to assess that lot based on its value as part of a group.” *First Interstate Bank*, 306 Or at 453 n2. The court observed, however, that the described situation was not before the court. In *Neupert*, which was decided subsequent to the *First Interstate Bank* case, the Tax Court directly addressed the claim that contiguous ownership could be considered when such common ownership derived a higher use for the parcel. The court rejected the claim, noting:

“Obviously, changes in ownership and use occur over time. Subject to statutory limitations or conditions such as ORS 308.210, it is within an assessor’s discretion to change property descriptions to adapt to these changes in land uses and land values. For example, small adjacent tax lots in the same ownership might be combined into a single tax lot which has a higher and better use.

However, *until that administrative action is taken*, separately assessed parcels of land must be valued on a stand-alone basis without regard to adjacent ownerships.”

Neupert, 13 OTR at 412 (emphasis added).

Based on the above, the court finds that the three tax lots at issue must be valued on a stand-alone basis, without regard to common ownership. Plaintiff submitted one appraisal for all three lots. In that appraisal, Plaintiff valued the parcels as one integrated property because the appraisers determined the HBU of the parcels was as a single campus. Plaintiff’s approach considered the common ownership of the parcels, in violation of principle announced in *Neupert*. Because Plaintiff’s appraisal considered the common ownership of the parcels, Defendant claims the court should completely disregard Plaintiff’s appraisal. Defendant refers the court to *Krummenacker* to support its contention.

In *Krummenacker*, the court addressed the question of whether a narrow strip of land could be considered as an “extension” of a contiguously owned lot. Citing *Neupert*, the court held it could not. Because the county had valued the strip as an “extension,” the court concluded the county’s appraisal must be disregarded. *Id.* at 168. Defendant, in the subject appeal, requests similar treatment for Plaintiff’s appraisal. The court finds, however, that Plaintiff’s appraisal should not be completely disregarded. Although Plaintiff’s appraisal, as submitted, violates *Neupert* by valuing the properties as a single unit, during trial, Plaintiff’s experts testified as to how the values could be allocated to each lot if valued independently. In effect, Plaintiff corrected and rehabilitated its appraisal through testimony. That is contrary to the situation in *Krummenacker*, where the county and Department of Revenue simply submitted the appraisal prepared in the Magistrate Division and chose not to actively defend the case. *Id.* at 165.

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Therefore, the court finds Defendant's Motion in Limine should be denied. The court will consider Plaintiff's appraisal, but only with regard to how it supports Plaintiff's expert testimony relating to separate values for each lot.

III. APPRAISALS

A. *Plaintiff's Appraisal*

Plaintiff's appraiser, Bryan W. Chase (Chase) valued the properties using the three commonly used approaches to value: cost approach, income capitalization approach, and sales comparison approach.

1. *Cost Approach*

Chase testified that he placed little to no weight on the cost approach because the buildings were all older and functionally obsolete. He observed that the buildings, except for Building 4, are all first generation hi-tech buildings. They do not have sufficient glass on the exterior and their inside systems and partitioning designs are not to today's standards. Chase also noted that the buildings are obsolete because power comes to the buildings from different areas, rather than one source. Further, Chase observed that the cafeteria in Building 3 is not desirable for a single user. Because Plaintiff did not rely on the cost approach, the court will not discuss it.

2. *Income Capitalization Approach*

Plaintiff's appraisal also contains an analysis using the income approach to value. Chase placed "secondary emphasis" on the approach in reaching his final determination of value. (Ptf's Ex 1 at 62.) Although the subject property is owner-occupied, Chase testified he used lease rates obtained from multi-tenant facilities. The rents ranged from \$.57 per square foot to \$1.02 per square foot. (*Id.* at 50-51.) Given the subject's larger size and its "older overall age," Chase determined a rate below the low-end was appropriate. He concluded a \$.50 per square

foot was a reasonable income for the subject properties. (*Id.* at 51.) He multiplied the square footage of Buildings 2, 3, and 4 of 217,157 by \$.50 per square foot. He then multiplied that total by 12 months to arrive at an annual potential gross income (PGI) of \$1,302,942. (*Id.*)

Chase testified that vacancy rates as of the assessment date, January 1, 2003, were between 20 to 30 percent. Striving to obtain a stabilized rate, Chase used a 10 percent vacancy rate, which resulted in an effective gross income (EGI) of \$1,172,648. (*Id.* at 51-52, 56.) Chase then used a rate of three percent of the EGI for management expenses and a rate of two percent of the EGI for reserves for replacement to arrive at a net operating income (NOI) of \$1,114,016. (*Id.* at 56.)

Chase then reviewed seven comparable sales for use in deriving a capitalization rate. He confirmed the sales data for each sale with the buyer or seller, rather than rely on published rates. The comparables indicated a capitalization rate range from 8.19 percent to 10.64 percent.¹⁰ (*Id.* at 54.) Due to the older age of the subject property, Chase concluded that a rate of 9.50 percent was appropriate. (*Id.* at 55.) Capitalizing the NOI by 9.50 percent results in a value of \$11,726,480. To this value, Chase added \$1,020,000 for the shell value of Building 1, which was derived using the cost approach, to arrive at a total value of \$12,746,480. (*Id.* at 56.) Finally, Chase determined that the first level of Building 2, which has the laser stalls, would require demolition for lease purposes. He determined a value of \$13.00 per square foot for demolition was appropriate. Multiplying that figure by 53,122 square feet (the square footage on the first floor of Building 2), Chase arrived at a deduction of \$690,586. Subtracting that figure
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¹⁰ Plaintiff's Exhibit 1 shows the bottom rate being 8.19 percent on pages 53 and 54. In his textual analysis on page 54, Chase stated the bottom rate was 8.12 percent.

from the derived value led to a final value conclusion of \$12,060,000 for the total property using the income approach to value. (*Id.*)

3. Sales Comparison Approach

Chase testified that he primarily relied upon the sales comparison approach in reaching a value conclusion for the properties. Chase used 12 sales in his analysis, with a value range of \$33.94 per square foot to \$174.68 per square foot. (*Id.* at 57-60) Many of the higher priced properties were primarily office buildings and do not compare favorably to the subject industrial properties. Chase determined that most of the sales were high indicators because they were newer and of superior condition. He testified that when the hi-tech market dropped, there were many buildings being built. Those new buildings were available for market on the assessment date and had the added appeal of no retrofitting required, in contrast to the subject properties. Of the 12 comparables, Chase testified that Sales 1 through 4 were the best indicators of value. Sale 1 was the Solectron property that sold in May 2004 for \$13,000,000, or \$33.94 per square foot. (*Id.* at 58.) The property is larger than the subject but, according to Chase, compared favorably because it had two buildings. He concluded that the comparable's location, however, was inferior to the subject. Sale 2 was the Gray Oak Corporate Park property. It sold in March 2004 for \$6,439,750, or \$53.06 per square foot. That property had two buildings - one of which was vacant and one that was a warehouse leased by Nike at the time of purchase. Chase testified Sale 2 has superior parking with a ratio of four spaces per 1,000 square feet.

Sale 3 was the Kentrox sale to Columbia Sportswear Company. Chase testified this property sold at the peak of the market in October 2000 for \$13,000,000, or \$69.15 per square foot. This property compares nicely to the subject property because it is located near the subject on the same street and in the same IND zone. Sale 4 was the FEI Company property that sold in

July 2002 for \$14,045,000, or \$78.03 per square foot. Chase testified that property was newer and in superior condition. He believed it had a more functional design and offered better parking. As a result, Chase concluded Sale 4 was a high value indicator. Chase testified that the first four comparable sales were all uses allowed in an IND zone and they all had manufacturing, research and development, and office space.

After considering all the information, Chase determined the subject properties would be in the low end of the range and concluded a value of \$50 per square foot was reasonable. (*Id.* at 60.) He applied that value to the total square footage of Buildings 2, 3, and 4 to arrive at a value of \$10,860,000. To that value, he added the shell value of Building 1 and subtracted the cost for interior demolition of Building 2 to arrive at a total value of \$11,190,000 for the property. (*Id.* at 61.)

4. *Reconciliation*

In his reconciliation, Chase concluded that the RMV of the subject parcels as of January 1, 2003, was \$11,200,000. At trial, Plaintiff's attorney asked Chase whether he could offer an opinion as to the value of the lots on a separate basis. He testified it would be difficult because the properties are interconnected in terms of parking, ingress and egress, drainage systems, and utilities. Assuming, however, that none of those problems were present, Chase testified he would allocate the value as follows:

Tax Lot 200	\$6,800,000 (using \$35 per square foot for Building 1 and \$100 per square foot for Building 4)
Tax Lot 300	\$1,900,000 (using \$35 per square foot, considering the substantial modifications required to the first floor and considering the second level as unusable space)
Tax Lot 400	\$2,500,000 (using \$50 per square foot)

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B. *Defendant's Appraisal - Tax Lot 200, Buildings 1 and 4*

Chris Werner (Werner) of Defendant's staff prepared the appraisal for Buildings 1 and 4 using all three approaches to value.

1. *Cost Approach*

Werner began by appraising the property using the cost approach to value. Using cost data from Marshall & Swift, he derived an estimated value of \$6,208,342 for Building 4 and \$1,228,208 for Building 1. (Def's Ex A at 11-12.) Recognizing Building 1 would require tenant improvements and HVAC, Werner subtracted \$797,762 as the total cost to cure the physical deficiencies in Building 1. (*Id.* at 13.) He estimated a value of \$167,320 of yard improvements (blacktop, sidewalks, curbs, and yard lights), which he added to the total. (*Id.*) Finally, based on five land sales, he derived a value of \$6.50 per square foot to arrive at a total land value of \$1,441,180. (*Id.* at 14.) Adding the figures together results in an indicated value for Tax Lot 200 of \$8,247,290 (rounded) using the cost approach to value. Werner gave the cost approach to value 10 percent weight in his overall consideration of value. (*Id.* at 29.)

2. *Income Capitalization Approach*

Werner also prepared an income capitalization approach to value in his appraisal. He gave the income approach primary reliance, assigning it 80 percent weight in his overall analysis. (*Id.*) Werner testified he gave primary weight to the income approach because investors are more interested in the income potential of a property than its price per square foot, as found in the sales comparison approach to value.

Werner began his analysis by selecting seven rent comparables. Those rent comparables were for buildings built from 1993 to 2001, with net rentable areas from 17,495 square feet to 63,785 square feet. (*Id.* at 15.) The rent comparables established a range of rent from \$8.75 per

square foot to \$16.84 per square foot. (*Id.* at 15.) He weighted each sale, based on its degree of comparability, and arrived at a weighted average rent of \$14.66 per square foot. (*Id.* at 19.)

Based on the weighted average, Werner assigned a lease rate of \$14.30 per square foot to the first and second floor of Building 4 and \$13.00 per square foot to the lower level. He then assigned Building 1 a lease rate of \$9.45 per square foot. (*Id.*) Applying each to the applicable square footage, Werner derived a PGI of \$1,057,860. (*Id.* at 23.)

Werner then determined that a stabilized vacancy rate of 20 percent was appropriate, based on a 2004 study prepared by Defendant and a vacancy survey prepared by Norris, Beggs and Simpson for the Sunset Corridor. (*Id.* at 19-20.) Applying a 20 percent vacancy rate, Werner derived an EGI of \$846,288. (*Id.* at 23.)

Werner then determined that expenses of eight percent of EGI should apply. He arrived at eight percent after concluding management expenses and reserves for replacement are typically each four percent of EGI. He allowed no other expenses, concluding most single tenant properties lease on a triple net basis. (*Id.* at 20-21.) By applying an eight percent expense rate to the EGI, Werner arrived at a NOI of \$778,585. (*Id.* at 23.)

Werner then selected a capitalization rate of 8.75 percent. He arrived at the capitalization rate two ways. First, he used the capitalization rates published by CoStar Group, a market data source, and he also used rates from the sales used in his sales comparison analysis. He used 10 sales from the CoStar Group occurring from April 12, 2002, to January 13, 2004. The rates ranged from 7.99 percent to 9.69 percent. (*Id.* at 21.) The estimated capitalization rates derived from Werner's comparable sales ranged from 5.23 percent to 9.85 percent. (*Id.* at 22.)

Analyzing the data, Werner determined that a rate of 8.50 percent was appropriate. To that rate, he added a .25 percent adjustment to reflect the risk and loss of income that would result from a

remodel of Building 1. Applying a capitalization rate of 8.75 percent to the NOI results in an indicated value of \$8,898,110. (*Id.* at 23.)

Werner subtracted from that value \$797,762 as the cost to cure Building 1, to arrive at an “as is” value of \$6,659,168. He then added a land value of \$1,441,180 to derive a total recommended value for Tax Lot 200 of \$8,100,350 (rounded). (*Id.*)

3. *Sales Comparison Approach*

Werner also used the sales comparison approach to value in his analysis. He assigned the sales comparison approach 10 percent weight in his overall analysis. (*Id.* at 29.) Werner began by selecting nine sales he determined were comparable. Those buildings were built from 1983 to 2002, with gross building areas ranging from 13,870 square feet to 89,005 square feet.

(*Id.* at 23.) The sales dates bracket the assessment date and range from a low price per square foot of \$113.80 to a high price per square foot of \$238.04. (*Id.*) Werner estimated the subject at \$150.00 per square foot. Using that price, he derived an RMV of \$12,455,700. From that total, he subtracted a cost to cure of \$797,762 to arrive at an “as is” value of \$11,657,940 (rounded). (*Id.* at 28.)

4. *Reconciliation*

As stated, Werner assigned 10 percent weight to both the cost approach and sales comparison approach to value, and he assigned 80 percent to the income capitalization approach to value. Doing so results in a total recommended value for Tax Lot 200 of \$8,470,800. (*Id.* at 29.)

C. *Defendant’s Appraisal - Tax Lot 300, Building 2*

Robert Ruiz (Ruiz) of Defendant’s staff prepared the appraisal for Building 2 on Tax Lot 200 using all three approaches to value.

1. *Cost Approach*

Like Werner, Ruiz used the Marshal & Swift data to determine the value of the property using the cost approach. Using the information, he arrived at an RMV for the building of \$7,454,634. (Def's Ex B at 26.) To that value, he added \$41,100 for yard improvements (blacktop). Ruiz then reviewed seven land sales ranging from \$6.15 per square foot to \$9.99 per square foot. From that data, he concluded a land value of \$6.50 per square foot was applicable, resulting in a total land value of \$1,384,500. (*Id.* at 24.) Adding the totals together, Ruiz arrived at a recommended value using the cost approach of \$8,880,000 (rounded). (*Id.* at 26.) At trial, Ruiz testified that he gave the cost approach little consideration in his overall value conclusion.

2. *Income Capitalization*

Ruiz also prepared an income capitalization approach to value. He testified that he gave the income capitalization approach and sales comparison approach equal weight in his overall valuation analysis. Ruiz began by selecting 12 rent comparables from the "office flex market" ranging from \$11.46 per square foot to \$13.77 per square foot. (Def's Ex B at 32.) Two of the leases had lease dates of January 2001, two had lease dates of June 2001, six were from 2003, and the rest were unavailable. (*Id.*) He determined comparable 1 was most similar to the subject. It rented for \$13.20 per square foot, was built in 1985, sits on 4.3 acres and is located in the same IND zone near the subject. (*Id.*) After analyzing all the comparables, Ruiz determined a rent of \$12.00 per square foot applied. Applying that rent to Defendant's square footage of the building of 108,631 square feet results in a PGI of \$1,303,572. (*Id.* at 34.)

Like Werner, Ruiz determined a vacancy rate of 20 percent applied, which results in an EGI of \$1,042,858. (*Id.* at 33-34.) Ruiz then concluded a 10 percent expense rate was appropriate which resulted in an NOI of \$938,572. (*Id.* at 34.)

To derive a capitalization rate to apply to the NOI, Ruiz used the six sales he had chosen as his comparable sales. (*Id.* at 35.) For each sale, he calculated the property's PGI, using actual lease rates.¹¹ Then, he subtracted an estimated vacancy rate of 20 percent and an estimated expense rate of 10 percent to arrive at an estimated NOI. He then divided each sale's estimated NOI by its sales price to reach a capitalization rate for each sale. Overall, the rates ranged from 5.82 percent to 8.4 percent. (*Id.*) Ruiz then weighted the sales to arrive at an overall rate of 7.0 percent. However, Ruiz acknowledged that the property presented additional risk because it is older and would require tenant improvements. As a result, he determined a rate of 8.0 percent should be used. (*Id.*) Capitalizing the NOI by 8.0 percent, Ruiz arrived at a value of \$11,732,148. From that value, he subtracted \$600,000 for cost to cure, arriving at a final value of \$11,000,000 (rounded). (*Id.* at 35.)

3. Sales Comparison Approach

Ruiz selected six comparable sales to use in his analysis, with prices ranging from \$99.27 per square foot for Sale 5 to \$152.91 per square foot for Sale 6. (*Id.* at 27.) Ruiz determined he should not use Sale 6 in his analysis because it was a "two-lot combination of flex office and a higher quality office" making adjustments "problematic." (*Id.* at 30.) Ruiz then adjusted the sales for time, age, and quality to arrive at an adjusted sale price per square foot of \$99, \$106, \$115, \$119, and \$138. (*Id.* at 28-29.) Ruiz determined a price per square foot of \$110 applied to the subject property. Multiplying that price by the square footage of 108,631 results in a value of \$11,949,000 (rounded). Subtracting \$600,000 for cost to cure, he arrived at his final estimate of value using the sales comparison approach of \$11,349,000. (*Id.* at 31.)

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¹¹ For Sale 1, Ruiz used the capitalization rate published by CoStar because he did not have income information available.

4. *Reconciliation*

Again, Ruiz determined the cost approach had little validity for this property. Instead, he relied equally on the income capitalization approach and sales comparison approach. Doing so, Ruiz arrived at a final recommended value for Tax Lot 200 of \$11,000,000. (*Id.* at 37.)

D. *Defendant's Appraisal - Tax Lot 400, Building 3*

Ruiz also appraised Building 3 and used the same approaches that he used when appraising Building 2.

1. *Cost Approach*

Again, using the Marshal & Swift factors, Ruiz arrived at a total value of \$2,447,212. (Def's Ex C at 24.) To that value, he added \$97,960 for blacktop to arrive at a total value of \$2,545,172. He calculated a land value of \$1,327,950 using \$6.50 per square foot based on the same land sales used in Exhibit B. (*Id.* at 22, 24.) Adding the land to the improvement value, Ruiz arrived at a total recommended value using the cost approach of \$3,873,122. (*Id.* at 24.) Ruiz testified that, like Building 2, he placed little weight on the cost approach.

2. *Income Capitalization Approach*

Ruiz used the same rent comparables for Building 3 that he used for Building 2, arriving at a similar \$12 per square foot. (*Id.* at 30.) Using that rent, a 20 percent vacancy rate, and 10 percent expense ratio, Ruiz arrived at an estimated NOI of \$429,840. (*Id.* at 32.) Ruiz again used the same six comparable sales used in his market analysis to derive a capitalization rate of 7.0 percent. (*Id.* at 33.) To that rate, he added .5 percent because the subject is "older * * * with some maintenance or tenant improvement issues * * *." (*Id.*) Applying a capitalization rate of 7.5 percent to the NOI results in an indicated value for the property of \$5,721,000 (rounded and reconciled). (*Id.* at 33-34.)

3. Sales Comparison Approach

Ruiz used the same six comparable sales that he used in appraising Building 2.

(*Id.* at 26-27.) He again excluded Sale 6 from his analysis. After adjusting the sales for time, age, and quality, Ruiz arrived at a weighted, adjusted price per square foot of \$115.

(*Id.* at 29.) Multiplying that price by the square footage of 49,750, Ruiz arrived at a recommended value of \$5,721,000 (rounded). (*Id.*)

4. Reconciliation

Ruiz again placed primary reliance on the income capitalization approach and sales comparison approach. Doing so, he arrived at a total recommended value for Tax Lot 400 of \$5,700,000. (*Id.* at 35.)

IV. VALUATION ANALYSIS

During the trial, considerable time was spent discussing the property's IND zone and the uses permitted in that zone. As quoted earlier, the IND zone's purpose is to "provide sites for all types of industrial uses * * * as well as to allow some commercial, office and service uses as accessory uses * * *." (Ptf's Ex 3 at 1.) Accessory uses that are incidental to an allowed use are permitted. The Code sets forth a variety of accessory uses. Of importance in this appeal, the IND zone permits the following office uses: "[a]dministrative offices related to the principal use," "[o]ffice and administrative uses unrelated to the permitted use where no more than ten (10) percent of the floor area of the use is used for the unrelated activity," and offices as part of an Industrial Business Park. (Ptf's Ex 3 at 3, 14.) Defendant's experts maintained that office use is permitted outright on a parcel in an IND zone if that office use is related to an industrial use found at another site. Defendant's experts also maintained that there are no restrictions on the amount of office space allowed, as long as the office space is accessory to an industrial use. For

example, Defendant claims that the use of a building in an IND zone could be 90 percent office and 10 percent industrial. Plaintiff maintains the office use must be on the same parcel as the industrial use and that “incidental” and “accessory” mean the office use must be less than the industrial use found on the parcel.

In its post-trial brief, Defendant’s counsel states that the court need not address the issue because “the highest and best use is for accessory office space relating to the principal industrial use on the same parcel e.g. the use within each building(s) on Tax Lot 200, 300 and 400 respectively include offices accessory to an industrial use.” (Def’s Response to Memo of Law Re Gov’t Restriction at 2 fn 1.) Although it appears Defendant agrees that, for these properties, the office use occurs with an industrial use, the zone of the property is important when reviewing the comparables each appraiser selected. Those comparables, to be truly comparable, must be for uses allowed within an IND zone. From that standpoint, the court believes it is important to understand the office uses allowed.

After considering the expert testimony provided on both sides, the court is persuaded that the IND zone permits office use only when on the same parcel as an industrial use, or when a part of an industrial business park, as is the situation with the subject properties. When on a single parcel, that office use must be “accessory” or “incidental” to the industrial use. Again, after considering the expert testimony, the court is persuaded most by Ben Schonberger’s testimony. Ben Schonberger is a Land Use Planner, and he testified that the office use, to be incidental to the primary industrial use, must be less than the industrial use.

In Werner’s appraisal of Buildings 1 and 4, the sales he chose in his sales comparison approach were pure office buildings. He admitted that, if office space was not permitted outright in an IND zone, then his sales comparison approach would not be accurate based on the

comparables chosen. Because he chose sales that would not be allowed in an IND zone, the court will not consider his market approach analysis. Werner testified that, in any case, he relied primarily on the income approach to value in his appraisal. Unfortunately, to derive the capitalization rate, Werner used the sales comparables to calculate the rate. If those sales are not reliable indicators for the sales comparison approach, they are not reliable for use in determining a capitalization rate for the subject properties. Werner also relied on the capitalization rates published by CoStar Group. However, upon cross-examination, Werner admitted he had no idea how those rates were calculated, which expenses were included, and how they related to the subject properties.

Ruiz approached the task by treating Buildings 2 and 3 as “flex-office” buildings. In his sales comparison analysis, all the comparables chosen were “flex-office” buildings. Plaintiff questioned, however, whether Buildings 2 and 3 fit within the standard definition of a flex-office building. In his appraisal, Ruiz quoted the CoStar definition of a flex-office as follows:

“A type of building designed to be versatile, which may be used in combination with office (corporate headquarters), research and development, quasi-retail sales, and including but not limited to industrial, warehouse, and distribution uses. A typical flex building will be one or two stories with at least half of the rentable area being used as office space, have ceiling heights of 16 feet or less, and have some type of drive-in door, even though the door may be glassed in or sealed off.”

(Def’s Ex B at 20.)

Ruiz also provided Norris, Beggs and Simpson’s definition of a flex-office as including “over 50% office Build-out,” “1-2 floors,” “[g]rade level doors, dock doors optional,” “[l]oading - common or concealed,” “[c]lear height 14’-18’,” “[p]arking ratio 3-4:100[0],” “[e]xtensive glass,” “[l]andscaping - campus like setting,” “[b]usiness park / campus environment, light manufacturing, R/D,” “[n]o common area.” (*Id.* at 20-21.)

The court agrees that Buildings 2 and 3 do not completely satisfy the definitions of flex-office based on their lack of office use, lack of extensive glass, and parking ratio problems (for Building 2). However, the buildings do satisfy many other areas of the definition and, for that reason, the court will not reject Ruiz's comparables outright. However, when reviewing the comparables, it becomes apparent there are differences. The comparables all had substantially more glass than Buildings 2 and 3. Further, the comparables were all newer than the subject buildings. When comparing them to the subject, Ruiz treated Buildings 2 and 3 as being built in 1985. The comparables were built in 1988, 1983/1999, 2001, 1999, and 1984/1989. (Def's Ex B at 28-29.) Ruiz adjusted only those sales built in 2001 and 1999 for age and condition. However, the main portion of Building 2 was built in 1965, with the wings added in the 1980s, and the main building continues to have its original wiring, piping, and water mains. Further, Building 3 was built in 1974.

Brad Fletcher (Fletcher), one of Plaintiff's witnesses, testified that another element of consideration is the location of the subject properties. Fletcher is a commercial real estate broker familiar with the market for flex-office space along the Sunset Corridor. He testified that the subject properties are not located within a traditional industrial area. Instead, the properties are located in an area of mixed uses. For example, the properties are located by a school and a Home Depot. Fletcher testified that the character of the neighborhood provides a stigma that must be accounted for in the appraisal. Ruiz made no adjustment for location, considering them all to be average. (*Id.* at 30.)

For the income approach, to derive the capitalization rate, Ruiz used the six comparable sales used in his sales comparison analysis. Although he found Sale 6 did not compare favorably and excluded it from his consideration in the market analysis, he included it for purposes of

deriving a capitalization rate. The court questions why Ruiz excluded Sale 6 in one approach, yet included it in another. Further, in his rate analysis, Ruiz used the comparables' actual sales prices, and divided those prices by an estimated NOI. He used the lease rates to derive a PGI, then estimated vacancy and expenses, to arrive at an estimated NOI. Plaintiff took issue with Ruiz's approach of dividing an actual price by an estimated NOI. The court agrees that actual data is preferred and produces a more reliable capitalization rate. As observed by the Appraisal Institute:

“Deriving capitalization rates from comparable sales is the preferred technique when sufficient data on sales of similar, competitive properties is available. *Data on each property's sale price, income, expenses, financing terms, and market conditions at the time of sale is needed.* In addition, the appraiser must make certain that the net operating income of each comparable property is calculated and estimated in the same way that the net operating income of the subject property is estimated; often the operating data available for the comparable sale properties is from the year that ended just prior to the date of value, so the appraiser may have to explain (or adjust for) the time difference. Both the income and expenses date (on the date of valuation plus the next 12 months) and the structure of expenses in terms of replacement allowances and other components should be similar to those of the subject.”

Appraisal Institute, *The Appraisal of Real Estate* 531 (12th ed 2001) (emphasis added). The court also observes that, in deriving the PGI for the comparables, at least four of the leases were entered into prior to the downturn in the industry. (Def's Ex B at 32.) Ruiz also relied on the rates published by CoStar Group, but testified he did not know how the rates were derived, *e.g.*, whether property taxes were included in the rate or whether reserves for replacements were included.

Another element of consideration is the manner in which the three parcels share services and access. Defendant's appraisers did not view the interconnectedness of the properties' systems as presenting problems. Werner testified he made a basic assumption that, because the lots are under common ownership, utility and access easements would be granted prior to any

sale, thus foreclosing any potential problems with the sharing of systems. However, it is inappropriate to assume easements based on the common ownership of lots. In *Corn v. Dept. of Rev.*, 7 OTR 407 (1978), the taxpayer owned a landlocked parcel with no right to irrigation water that could be used for domestic purposes. The taxpayer, however, owned a contiguous parcel that could provide access to the subject parcel and had domestic water. The county appraiser assumed the parcel at issue could use the contiguous lot's water rights and the contiguous lot for access. Based on those assumptions, the county appraiser made no adjustments for water and access. The court disagreed with the county's approach, concluding:

“[The county appraiser's] assumption respecting the irrigation water is improper. The county's theory is essentially that, since [the plaintiff] owns both Tax Lot 1000 and the subject property, any advantages or amenities enjoyed by one of the lots automatically is transferred to the other lot as well. Such a theory is completely inappropriate when valuing the subject property as an independent parcel subject to sale in the market. * * *

“[The county appraiser's] adjustments for access * * * are equally inadequate. * * * [The county's appraiser] stated that he felt such adjustments were inappropriate since it is the county's position that when two adjacent parcels are in the same ownership, as in this case, and there is existing access to one of the parcels, access is automatically available to the other parcel * * *. This position is improper for the same reasons that it was improper to assume that the subject property would automatically be able to use the irrigation water from Tax Lot 1000. What [the county's appraiser] has done, in fact, is to include in the value of the subject property a nonexistent easement over Tax Lot 1000 * * *.”

Corn, 7 OTR at 412-13.

The court has already mentioned problems presented by Defendant's appraisals. In addition, the court observes that Defendant's appraisers presented a general lack of experience with industrial appraisals, lack of familiarity with the hi-tech industry, and lack of knowledge regarding the subject properties. Werner testified that this was his first hi-tech appraisal. He observed that he believed Building 4 contained research and development labs because there was a room with “computers and gadgets.” He was not certain what the purpose was for the

equipment because he was “not into the hi-tech industry.” He also “thought” there were laser stalls in Building 4, even though Daniel Klepel, Plaintiff’s Corporate Facilities Manager, did not testify to the presence of laser stalls in Building 4.

Ruiz testified that this was his first industrial appraisal. He testified that, as to Building 2, he was not certain about the number of laser stalls present and he was not sure if there were any offices on the first floor. It is the appraiser’s responsibility, however, when appraising a property to gain an understanding of the industry at issue and to fully understand the property being appraised.

After carefully considering the appraisals submitted by the parties, the court finds that Plaintiff’s appraisal, although not perfect, presents the more reliable indicator of value for the subject property. Both Werner and Ruiz admitted that the market on January 1, 2003, was difficult because there were newer buildings on the market and fewer sales due to owners waiting for the market to rebound. Experts referred to the Sunset Corridor as being a “cemetery” that only recently has rebounded. (Ptf’s Ex 10.) The court believes Defendant’s appraisals fail to adequately reflect and account for the difficult economic times facing the industry as of January 1, 2003. The court finds that Plaintiff’s value conclusions better reflect the true RMV of the properties.

IV. CONCLUSION

It is the conclusion of the court that Plaintiff’s appraisal provides the most reliable indicator of value for the subject properties. Now, therefore,

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IT IS THE DECISION OF THIS COURT that the 2003-04 RMVs of the subject parcels are as follows:

Account R633345, Tax Lot 200 (Buildings 1 and 4)	\$6,800,000
Account R633327, Tax Lot 300 (Building 2)	\$1,900,000
Account R633336, Tax Lot 400 (Building 3)	\$2,500,000;

IT IS FURTHER DECIDED that the 2003-04 RMV of the machinery and equipment in Account R633345 is \$-0-;

IT IS FURTHER DECIDED that the 2003-04 RMV of the machinery and equipment in Account R633327 is \$164,400; and

IT IS FURTHER DECIDED that the 2003-04 RMV of the personal property in Account P852848 is \$9,153,172.

Dated this _____ day of October 2006.

COYREEN R. WEIDNER
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 Coyreen R. Weidner on October 27, 2006. The Court filed and entered this document on October 27, 2006.