

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Property Tax

FOUR RIVERS COMMUNITY SCHOOL,)	
INC., an Oregon non-profit corporation,)	
)	
Plaintiff,)	TC-MD 040924E
)	
v.)	
)	
MALHEUR COUNTY ASSESSOR,)	
)	
Defendant.)	DECISION

Plaintiff appeals Defendant’s denial of its claim for a 2004-05 property tax exemption. A telephone trial in the matter was held November 18, 2004. Charles Oakes, Attorney, appeared on behalf of Plaintiff. Richard Thurmond, Chief Appraiser, appeared on behalf of Defendant.

I. STATEMENT OF FACTS

Plaintiff is a charter school located in Ontario, Oregon. Its first year of operation was the 2003-04 school year. The school is located in a 10,500 square-foot building on a 1.87 acre parcel of land. The size of the land provides ample parking space for buses, and 1.22 acres of the parcel is considered surplus land that is used for the school’s playground.¹ Plaintiff looked at several properties before deciding to lease the subject property. It chose to lease the subject property due in part to its parking space and excess land. The lease agreement provides that, for the period from September 1, 2003, to August 31, 2004, Plaintiff paid a monthly rent of \$3,000 on a triple net basis. The rent increased to \$3,750 a month for the following school year. (Ptf’s Ex 1.) The subject property had previously been used as a furniture store with United Furniture Warehouse leasing the property. (Ptf’s Ex 6.) That lease commenced March 1, 1999, with a monthly rent of

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¹ The property is identified in Defendant’s records as Accounts 8245 and 1982.
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\$4,700 for the first five years. United Furniture Warehouse subsequently vacated the premises, which allowed Plaintiff to then lease the property.

Plaintiff filed an application for property tax exemption with Defendant in March 2004 requesting exemption for the 2004-05 tax year. Defendant denied the exemption for the reason that Plaintiff failed to provide sufficient proof that its rent was below market. Plaintiff appeals Defendant's denial to this court.

During an early telephone conference with the court, it was observed that the original lease was silent as to the tax savings inuring to the benefit of Plaintiff. Plaintiff argued that, as a triple net lease, any tax savings would automatically flow to Plaintiff. However, to make clear what may otherwise have been implied, Plaintiff executed an addendum to its lease. (Ptf's Ex 2.) In that addendum, the parties state that the rent was established to reflect the tax savings resulting from an exemption from taxation. (*Id.*)

Plaintiff argues that the property is entitled to exemption because it is an exempt entity that realizes the benefit of any tax savings. Defendant argues that the exemption should be denied, claiming Plaintiff's rent is not below market.

II. ANALYSIS

ORS 307.112² governs exemptions of property when a taxable owner leases property to an exempt lessee. It states, in pertinent part:

“(1) Real or personal property of a taxable owner held under lease * * * by an institution, organization or public body * * * granted exemption or the right to claim exemption for any of its property * * * is exempt from taxation if:

“(a) The property is used by the lessee in the manner, if any, required by law for the exemption of property owned or being purchased by it; and

² All references to the Oregon Revised Statutes (ORS) and Oregon Administrative Rules (OAR) are to the 2003 provisions.

“(b) It is expressly agreed within the lease or lease-purchase agreement that the rent payable by an institution, organization or public body has been established to reflect the savings below market rent resulting from the exemption from taxation.”

ORS 307.112(1) (emphasis added).

The statute requires that a lease agreement between a taxable owner and exempt lessee expressly provide that the lease payment was set to establish the tax savings that would result from exemption. Essentially, the legislature is looking for a statement to demonstrate the parties considered the financial consequences of the exemption. Plaintiff’s original lease failed to mention anything about the tax savings flowing through to Plaintiff as a result of an exemption. Plaintiff argues that no language was required because the lease was established as a triple net (NNN) lease and, consequently, the tax savings automatically flow to Plaintiff. However, to alleviate any doubt, Plaintiff executed an addendum to its lease wherein it stated the following:

“The purpose of this addendum is to reduce to writing our mutual understanding that the lease amounts in this lease are substantially below market due to the Lessee’s non-profit status as a charter school other than the State of Oregon. The rent (lease amounts) payable by the institution, organization, or public body (Lessee) has been established to reflect the savings below market rent resulting from the exemption from taxation. To substantiate this we would like to note that the previous tenant was paying \$4,982 NNN/month and the Four Rivers Community School is paying \$3,000 NNN/month.”

(Ptf’s Ex 2.)

The addendum is not dated but indicates it is to be “made part of the lease agreement effective the beginning of the lease term, August 7, 2003.” (*Id.*) Defendant argues that the statutory requirements cannot be satisfied in a retroactive manner. However, prior cases have held that the intent of the parties controls the meaning of an agreement. *Miller v. Miller*, 276 Or 639, 555 P2d 1246 (1976). If the parties express an intent to bind themselves as of an earlier date, the court gives effect to that intention. *See Multnomah County v. Dept. of Rev.*, 13 OTR 384, 386-87 (1995) (noting that “[p]arties can make agreements retroactive and thereby bind

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themselves as of the date the agreement specifies” (citing *Beach v. Brightwood Co.*, 132 Or 345, 285 P 259 (1930))). Here, the addendum is clear that the lease always contemplated that the tax savings would flow to Plaintiff. Therefore, the court accepts the lease addendum as fulfilling the statutory requirement of an express agreement.

Defendant further argues that ORS 307.112 requires a demonstration that the rent payable by the lessee is below market. Defendant claims that Plaintiff has failed to demonstrate its rent is below market and, as a result, exemption is not appropriate. Plaintiff counters that, with a NNN lease, the tax savings resulting from the exemption automatically flow to Plaintiff, thereby fulfilling the statutory requirements. As a result, savings in the form of decreased rents need not occur. Plaintiff further argues that, in any event, its lease payments are in fact below market.

ORS 307.112(1)(b) requires that the rent payable by the exempt organization be “established to reflect the *savings* below market rent resulting from the exemption from taxation.” (Emphasis added.) With a NNN lease, *the landlord experiences no tax savings*. As a result, there are no savings to flow through to the exempt lessee. In that regard, the statutory requirements are met by a NNN lease.

The court observes that the statutory language appears to contemplate a gross lease situation. With a gross lease, the landlord bears the burden of the property tax expense. If the property becomes exempt, the landlord no longer pays that expense. The legislature, however, wanted to make certain that the benefit of exemption was realized by the exempt entity. As a result, it required the landlord to reduce the rent as a way of offsetting his savings from not paying property taxes. With a NNN lease, those benefits are realized directly by the exempt entity. As a consequence, the rent need not be below market. When comparing what an exempt entity pays under a NNN lease compared to a nonexempt entity, the exempt entity is paying less because it does not have the expense of property taxes.

ORS 307.112, in essence, requires that the landlord remain in a neutral financial situation. In a gross lease situation, the landlord's financial situation is constant whether he leases to an exempt entity or a nonexempt entity. If he leases to a nonexempt organization, he pays the property taxes but also is able to charge more rent. If he rents to an exempt entity, he no longer has the expense of property taxes, but he must charge less rent to offset that benefit. Similarly, a landlord's financial situation should remain constant whether he leases on a NNN basis to an exempt entity or a nonexempt entity. Defendant's argument that, even with a NNN lease, the rent must be below market requires the landlord to, in that situation, assume a worse financial situation. That is not the intent of the statute. The exempt lessee should not receive a benefit over and above the tax savings, particularly when it would be to the detriment of the lessor.

The court observes that the administrative rule related to the statute provides that "[a] statement that the 'lessee is responsible for the taxes' is not sufficient proof of a tax savings." OAR 150-307.112(10). Although not entirely clear, it appears the rule anticipates an inquiry into the rents be made to ensure that, if the lessee pays taxes, the rents do not increase above market to offset that benefit. Both parties submitted rent information to support their claims.

Plaintiff first claims that the rent per square foot of the subject property is \$3.45. In doing so, Plaintiff used a monthly rent of \$3,000 for the period from September 1, 2003, to August 31, 2004. Defendant, in its analysis, used a rent per square foot of \$4.31, which was based on a monthly rent of \$3,750 for the period from September 1, 2004, to August 31, 2005. The tax year at issue is the 2004-05 tax year, with an assessment date of January 1, 2004. On that date, the monthly rent was \$3,000. The court finds, therefore, that \$3.45 per square foot is the appropriate rent to use for the subject property when comparing other rents against it.

Plaintiff offered as evidence the rent paid by United Furniture Warehouse, the prior tenant of the property. Its rent was \$4,700 per month, or \$5.37 per square foot, for the first five years

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and was effective April 1, 1999. (Ptf's Ex 6 at 1.) Plaintiff also offered as evidence an appraisal prepared by Alan Marchbanks (Marchbanks) as of March 15, 1999, for United Furniture Warehouse. In his appraisal, he concluded that the property should rent for \$6.30 per square foot on a NNN basis. (Ptf's Ex 7 at 11.) He based his conclusion on analyzing the rents of comparable properties. At trial, Marchbanks acknowledged that the retail market had in the past few years shifted to the other side of town and that it would be more difficult today to attract a regional tenant to the subject property. As a result, rents would be lower today due to the decreased economic activity.

Also testifying for Plaintiff was LeRoy Atwood, who was involved in the venture to lease out the old Ernst building in Ontario. He develops real estate professionally and is experienced with the local market. He testified that, in his experience, the property would rent on the open market for \$8.00 per square foot on a NNN basis. He further testified that the old Ernst building was rented to the Department of Human Services for \$10.47 per square foot. However, as part of that lease, the owners had to invest \$1.4 to \$1.6 million to convert the property for the state.

Finally, Plaintiff submitted evidence of a proposed lease it had with the Oregon Child Development Coalition, Inc. Plaintiff was in negotiations to lease space from that organization for \$6.00 per square foot. (Ptf's Ex 5.) The space, however, was only 2,640 square feet. Plaintiff presented all of the evidence to demonstrate its rent for the subject property is below market.

Defendant claims Plaintiff's rent is above market. To support its claim, Defendant submitted evidence of three comparable properties. Those properties had rents of \$1.44, \$2.85, and \$1.17 per square foot. (Def's Ex A at 1.) Compared to Plaintiff's rent of \$3.45 per square foot, Defendant claims Plaintiff's rent is too high.

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Comparable One has 16,674 square feet. At trial, Plaintiff questioned Gerri Davis (Davis), who prepared the analysis, about the finished square footage of the comparable. It became clear throughout the testimony that only a portion of the building had vinyl and HVAC, thus reducing its comparability. Plaintiff also raised questions about whether the lease was between related parties and whether the rent used by Defendant was a base rent with additional rent tied to profitability owing. Plaintiff presented no evidence to support its claims, and Davis relied only on the verbal information she had received from the manager of the business.

Comparable Two is leased by Fit for Life with a rent of \$2.85 per square foot. The building sits on a site of .69 acre as compared to 1.87 acres for the subject. Plaintiff notes that one of the main features of the subject property is the size of the land for parking, bus spaces, and playground. Evaluating simply on a rent per square foot of the building does not account for that acreage. Further, Plaintiff questioned whether Defendant used the correct rent, claiming it should be \$4.75 per square foot, based on discussions with the owner. Davis testified that she used the rent figures provided to her from the lessee. Neither party provided evidence to substantiate their claimed rent information.

Comparable Three is located near the subject property. Defendant claims the property rents for \$1.17 per square foot. Again, the parties disputed over the rent information with nothing to substantiate their claims. Further, the parcel is only .30 acre, distinguishing itself from the subject property.

Defendant also submitted an extensive rent study prepared by Davis. (Def's Ex B.) Davis testified it took her a year to complete the study. She gathered rent information from numerous properties and separated them into categories of "good retail," "average retail," and "low cost retail." She then applied a regression line to the data gathered. Based on the study, she believes the subject should rent for \$2,445 per month on a gross lease basis, resulting in a rent

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per square foot of \$2.79. Davis testified that rents on the west side of the community have decreased significantly in the past few years as the retail market shifted to the east side of town. As a result, the subject property would rent for less than what it did when leased by United Furniture Warehouse. Upon reviewing the study, the court observes that all lease types were included in the study, although it appears most were gross leases.

The parties presented significantly different opinions as to the rents commanded in the area. Plaintiff presented historical information, appraisal information, and expert information as to the rates, all of which were higher than the subject rent. Defendant presented rent comparables and a rent study to suggest the rent is too high. The evidence presented by both sides was not without criticism or debate. On the whole, however, one thing is clear to the court, the property's rent of \$3.45 per square foot fits adequately within the range of evidence presented. As a result, the court is persuaded that the property is being rented for an acceptable market rent.

III. CONCLUSION

When a taxable owner leases property to an exempt entity on a NNN basis, the owner has no tax savings resulting from the exemption. As a result, the owner is not required to reduce the rent below market because the owner has no savings to pass through to the exempt lessee. A market rent is sufficient and the evidence persuades the court that Plaintiff's rent is not above market. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff's appeal is granted;

IT IS FURTHER DECIDED that the property identified in Defendant's records as Accounts 8245 and 1982 shall receive a property tax exemption for tax year 2004-05; and

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IT IS FURTHER DECIDED that Defendant shall amend the tax rolls to reflect the exemption and refund the excess taxes paid, if any, to Plaintiff with statutory interest.

Dated this _____ day of May, 2005.

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 May 12, 2005. The Court filed and entered this document May 12, 2005.