IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Property Tax

CHAMBERS MANAGEMENT CORP and McKENZIE RIVER MOTORS,	)	
Plaintiffs,	)	TC-MD 060354D
v.	)	
LANE COUNTY ASSESSOR,	)	
Defendant.	)	**DECISION**

Plaintiff appeals the real market value of its improvements for tax year 2005-06. A telephone trial was held on Tuesday, January 23, 2007. David E. Carmichael, Attorney at Law, appeared on behalf of Plaintiffs. Susan Wright (Wright), Property Manager, Chambers Management Corp., testified. William Mahn (Mahn), Commercial Appraiser, appeared and testified on behalf of Defendant.

The parties' exhibits were offered and received without objection. The parties stipulated that the gross income, vacancy rate, operating expenses, and net operating income set forth in Defendant's Exhibits J and X were correct.

I. STATEMENT OF FACTS

The subject improvements under appeal are located on two adjacent land parcels identified as Accounts 0291201 and 0291193. The physical address of Account 0291201 is 1815 Garden Avenue, Eugene, Oregon, and is a two story 5,952 square foot office building. (Def's Ex C.) That building will be referred to as the Chambers Building. The physical address of Account 0291193 is 1839 - 1851 Garden Avenue, Eugene, Oregon, and is a two story 6,402 square foot office building and 3,864 square foot warehouse. (Def's Ex Q.) That building will be referred as the McKenzie Building.

Wright, who has been the property manager for over seven years, testified that as of the assessment date, January 1, 2005, both office buildings were rented on a month-to-month basis to Oregon Center for Applied Science (Tenant). She stated that Tenant, who had been renting under a long term lease, moved to a month-to-month agreement in the Chambers Building on September 30, 2003, and the McKenzie Building on August 1, 2004. (Ptf's Ex 1 at 2.) Wright testified that the McKenzie Building warehouse was not rented. After giving 60 days notice, Tenant moved out of the buildings on May 5, 2006. (*Id*.)

Wright testified that each of the buildings is "over 40 years old" and in need of substantial repair and deferred maintenance. Reading from an 11 page list, she described the following problems related to the improvements: entire roof needs to be replaced; gutters are "failing"; heat and cooling system is very old and "four or five of the units on the roof" need to be replaced; siding is deteriorating; the second floor railings are "failing"; windows are leaking; stairs, which have been installed and replaced twice, are poorly designed; and all lighting needs to be "upgraded." Wright testified that the property owner and her daughter concluded the cost to cure those problems would be "exorbitant." According to Wright, they made the decision to demolish the buildings after Tenant found a new location. The buildings were demolished in June 2006. (Ptfs' Exs 5, 8.)

Wright testified that the improvements in their current state of disrepair added little value to the land. She stated that the value of the improvements should be based on the net operating income for tax year 2005. To that amount, Wright added four-twelfths of the 2005 net operating income to recognize the four months the property was rented in 2006 before Tenant vacated the property. She concluded that the net operating income should be allocated between the land and building using Defendant's real market values on the 2005-06 tax roll. For the Chambers Building, Wright concluded that the 2005-06 real market value of improvements should be

$29,082. For the McKenzie Building, she concluded that the 2005-06 real market value of improvements should be $23,421.

Wright, who is not a certified appraiser, answered in the affirmative when asked if she knew that appraisers "rely" on the book titled "The Appraisal of Real Estate" 12th Edition. The following passage was read:

> "When a lease provides for a level stream of income or when income can be projected at a stabilized level, one or more capitalization procedures may be appropriate depending on the investor's assumptions with respect to capital recovery. Capitalization can be accomplished using capitalization in perpetuity. In the past, the present worth of an income stream was also calculated using the Inwood premise or the Hoskold premise, which are discussed in Appendix C."

Appraisal Institute, *The Appraisal of Real Estate* 559-60 (12th ed 2001.)

After the passage was read, Wright testified that because Tenant was on a month-to-month rental agreement, and the property owners decided that the buildings would be demolished, the income stream from the improvements should not be capitalized "in perpetuity." She believes that it is correct to total the actual net operating income in 2005, plus an estimate of the 2006 net operating income, and allocate the computed total net operating income between the land and buildings to determine the real market value of the subject property.

Mahn, a certified appraiser since 1989 and a commercial appraiser since 1992, testified that the improvements existed on the date of assessment, January 1, 2005, and were leased on a month-to-month rental agreement with the same Tenant who previously leased the improvements on a long term agreement. Mahn testified that, in his opinion, rents paid by tenants "attest to the condition" of a building and reflect the "worth to the tenants." In the facts of this case, he stated that Tenant gave notice two and one-half years before vacating the Chambers Building, and one and one-half years before vacating the McKenzie Building. In addition, Mahn testified that the buildings were not demolished "until 18 months after the date of assessment." In response to whether he had viewed the interior of the buildings, Mahn testified that he visited the property and was very familiar with the property, but did not view the interior of the buildings.

Mahn prepared an appraisal report, using the income and comparable sales approaches to determine the value of the subject property. Using the income approach, he determined a real market value of $428,500 for the Chambers Building and $686,160 for the McKenzie Building. (Def's Exs C, Q.) Mahn developed his capitalization rate of 8.5 percent for the Chambers Building, and 8.0 percent for the McKenzie Building, using the sale of three properties of comparable size located within three miles of the subject property. (Def's Exs J, X.) He added a property tax rate to the "discount rate" to arrive at the capitalization rate. Mahn testified that he did not personally verify the reported lease income, sale price, or condition of the buildings that he used as comparable sales. Mahn testified that he did not know if the comparable sale properties required repairs or maintenance similar to that listed by Wright for the subject property. He did state that an estimated real market value could be reduced by the cost of repairs and maintenance; however, Plaintiffs failed to provide a cost estimate to him or the court. In defending his determination of value, Mahn stated that because he used the actual income generated by renting the improvements under appeal, and those rents reflect the value of the improvements to the tenants, his estimate of value should be correct.

Using the market or comparable sales approach, Mahn determined a real market value of $439,000 for the Chambers Building and $681,190 for the McKenzie Building. (Def's Exs C, Q.) In arriving at those value determinations, Mahn used the same three sales of comparable size buildings that he used to develop the capitalization rate. (Def's Exs H, V.)

Mahn's correlation and final value conclusion of the "fee simple value" for the land and buildings are: Chambers Building: $430,000; McKenzie Building: $685,000. (Def's Exs C, Q.)

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His determination of value of the Chambers Building is comparable to the tax roll value. (Def's Ex C.) However, Mahn's determination of value of the McKenzie Building is approximately $43,000 more than the tax roll value. (Def's Ex Q.)

II. ANALYSIS

The issue before the court is the real market value of Plaintiffs' improvements. Real market value is the standard used throughout the ad valorem statutes except for special assessments. *See Richardson v. Clackamas County Assessor*, TC-MD No 020869D, WL 21263620, at *2 (Mar 26, 2003) (citing *Gangle v. Dept. of Rev.*, 13 OTR 343, 345 (1995)). Real market value is defined in ORS 308.205(1),[1] which reads:

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

There are three approaches of valuation (cost, income, and comparable sales) that must be considered in determining the real market value of a property even if one of the approaches is found to not be applicable. *See* ORS 308.205(2) and OAR 150-308.205-(A)(2).

Having agreed that the highest and best use of the subject property is a commercial office building, the next issue "is the market value of the property at that use." *Freedom Fed. Savings and Loan v. Dept. of Rev.*, 310 Or 723, 727, 801 P2d 809 (1990). That use is:

> "affected by how much the existing improvements contribute to property value. * * * The contribution of the improvements is estimated by subtracting the market value of the land from the market value of the total property. When improvements do not contribute to the overall property value, demolition is usually appropriate."

Appraisal Institute, *The Appraisal of Real Estate* at 334.

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[1] All references to the Oregon Revised Statutes (ORS) are to 2003.

Plaintiffs allege that the subject property adds very little if any value to the "overall property value" and "demolition is * * * appropriate." *Id.*

In a case such as this one before the court, the comparable sales approach "may be used to value improved properties, vacant land, or land being considered as though vacant." *Id.* at 335. Plaintiffs did not present a comparable sales approach to the court. Mahn presented selected sales of comparable size properties located in close proximity to the subject property. However, the comparability of the sales to the subject property is unknown because Mahn did not have rental agreement information, nor did he inspect either the subject property or the properties he identified as comparable. Even though the court concludes a comparable sales approach could be used to determine the real market value of the subject property, it is concerned that in this case the underlying data for the comparable sales chosen by Defendant was not verified.

The income approach can be used to value "[a]ny property that generates income." Appraisal Institute, *The Appraisal of Real Estate* at 472. The method uses the net operating income of the property for a single year. After determining the net operating income, a capitalization rate is determined and applied to the net operating income to determine an overall property value.

"All income capitalization methods, techniques, and procedures attempt to consider anticipated future benefits and estimate their present value. This may involve either forecasting the anticipated future income or estimating a capitalization rate that implicitly reflects the anticipated pattern of change in income over time." *Id.* at 471. Applying those principles to this case, at the date of assessment, the subject property was currently being rented on a month-to-month agreement by Tenant who previously rented on a long term basis. The month-to-month rental agreement had been in place for many months and the gross rent collected was almost the same in 2005 as 2004.[2] (Ptfs' Exs 1at 3 - 4, 6 - 7.) Using the past and current rental income to forecast the amount of "anticipated future income" in this case may not result in a reliable projection of income. Appraisal Institute, *The Appraisal of Real Estate* at 471. Further, difficulty arises in "estimating a capitalization rate that implicitly reflects the anticipated pattern of change in income over time." *Id.* Because Plaintiffs did not set a date for the demolition of the subject improvements, leaving it open until after Tenant moved to a new location, the perceived risk of loss of revenue at some point was extremely high, and the "change in income over time" was unknown. Given the inability to project a stabilized level of operating income, the income method cannot be used to determine the value of the subject property.

Plaintiffs modified the income method to determine the real market value of the subject property. Plaintiffs stipulated to the net operating income determined by Defendant. Plaintiffs concluded that because the structures were demolished in the following year, a capitalization rate is not appropriate when the income stream is not indefinite. Plaintiffs also concluded that the total net operating income correctly determined the real market value of the property, land, and improvements. "Taxpayer has the burden to show that its approach to valuation best reflects the property's 'real market value.' ORS 305.427; *Freedom Fed. Savings and Loan*, 310 Or at 727." *STC Submarine, Inc. v. Dept. of Rev.*, 320 Or 589, 597, 890 P2d 1370 (1995). There is no statutory or administrative rule allowing a taxpayer to determine real market value based on the income approach using the net operating income without applying a capitalization rate. In this case, the court is "not persuaded to adopt" Plaintiff's modified income "approach." *Id*.

[2] The Chambers Building month-to-month agreement began September 30, 2003. The McKenzie Building month-to-month agreement began August 1, 2004. (Ptfs' Ex 1at 2.)

The third approach to use in determining real market value is the cost approach. The total real market value determined by the cost approach can be reduced by the "depreciated cost of the improvements on the improved property." Appraisal Institute, *The Appraisal of Real Estate* at 335. Given Wright's testimony about the cost-to-cure and the costs to construct new buildings, the underlying data to determine value using the cost approach might have been available to Plaintiffs. Unfortunately, the court was not provided with any cost information, and the parties concluded that the cost approach was not applicable.

III. CONCLUSION

After careful review of the applicable law, administrative rules and evidence, the court does not agree that Plaintiffs' modified income approach results in the correct determination of the real market value of improvements. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiffs' appeal must be denied.

Dated this _____ day of April 2007.

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JILL A. TANNER
PRESIDING 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 Presiding Magistrate Jill A. Tanner on April 3, 2007. The Court filed and entered this document on April 3, 2007.