BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203 Petitioner: **CARRAMERICA REALTY LP,** v. Respondent: **ARAPAHOE COUNTY BOARD OF EQUALIZATION.**	▲
Attorney or Party Without Attorney for the Petitioner: Name: Layne F. Mann, Esq. Address: 7475 West Fifth Avenue, Suite 321 Lakewood, Colorado 80226 Phone Number: (303) 233-8533 E-mail: Attorney Reg. No.: 15611	**Docket Number: 35914**

ORDER

THIS MATTER was heard by the Board of Assessment Appeals on July 11 and July 19, 2001, Karen E. Hart, Judee Nuechter, and Debra A. Baumbach presiding. Petitioner was represented by Layne F. Mann, Esq. Respondent was represented by George Rosenberg, Esq.

PROPERTY DESCRIPTION:

Subject property is described as follows:

TRACTS 7 & 8 TOG WITH N ½ VAC E MAPLEWOOD AVE ADJ EX RDS SEC 21-5-67 CLARK COLONY
(Arapahoe County Schedule No. 2075-21-2-02-020)

Petitioner is protesting the 1999 actual value of the subject property, two multi-tenant office buildings located on one parcel, known as the Harlequin Plaza complex. The buildings were constructed in 1980 and consist of 340,880 gross square feet.

ISSUES:

Petitioner:

Petitioner contends that all three approaches to value were considered: income, market and cost. The most weight was given to the income approach. The difference between the two parties is the way tenant finish, leasing commissions, and reserves were treated in the income approach. The county has changed the way it handles these expenses since the last reappraisal.

Respondent:

Respondent contends that all three approaches to value were considered. Both sides focused on the income approach; the difference is in the calculation of the capitalization rate and what items should be included in it. Petitioner's approach is theoretical, not real life. There is sufficient market data available, so there is no need to use theories.

FINDINGS OF FACT:

1. Petitioner's witness, Dr. Jeffrey D. Fisher, Ph.D., Director of the Center for Real Estate Studies at Indiana University, testified via teleconference call. He is not a licensed appraiser in any state.

2. Dr. Fisher testified that he wrote pages 107 through 111 in Petitioner's Exhibit A. He explained the difference between a leased fee estate (based on actual rent rolls and current tenants) and fee simple estates (assumes current market rents). He testified that reserves for replacements should be included when calculating net operating income for direct capitalization in a fee simple valuation.

3. Dr. Fisher testified that you should not use capitalization rates taken from leased fee sales and apply them to a fee simple value without making adjustments. In an increasing market, rent rolls will be below market value. Adjustments should be made for growth expectations, risk, and tenant improvement (TI) and leasing fees. He believes that leasing fees and tenant improvements should be deducted as expenses, but if not, they should then be reflected in a higher capitalization rate; they must be accounted for somehow.

4. Under cross-examination, Dr. Fisher testified that he believes that deriving capitalization rates from comparable sales is appropriate for leased fee, not fee simple analysis. He is aware that Colorado is a fee simple state. The *Korpacz Real Estate Investor Survey* is nationally recognized and supplies overall trends in rates, but does not usually use overall capitalization rates. He testified that when investors are going to purchase properties based on current leases, they will need to look at what TI and leasing expenses will be in the future.

5. Petitioner's witness, Mr. Matthew W. Poling, CPA and tax manager for Deloitte & Touche Property Tax Services, presented the following indicators of value:

Market:	$23,641,700.00
Cost:	$24,244,000.00
Income:	$24,600,000.00

6. Mr. Poling testified that the level of value date is June 30, 1998. His analysis resulted in a value of $24,600,000.00 versus the assigned value of $30,000,000.00. The subject property consists of two buildings located on one parcel, and is known as the Harlequin Plaza complex. Petitioner purchased the subject property in May of 1996 for $23,900,000.00.

7. Petitioner's witness presented a cost approach to derive a market-adjusted cost value for the subject property of $24,244,000.00.

8. Petitioner’s exhibit contained a cost approach determination, but Mr. Poling did not testify to this approach. Notes in the exhibit indicate that no weight was given to this approach due to the age of the property and the ability to calculate a value using an alternate approach.

9. Petitioner's witness presented an income approach to derive a value of $24,600,000.00 for the subject property.

10. Mr. Poling testified that he used a net leasable area of 331,485 square feet, according to the actual rent rolls. He used a rental rate of $18.50 per square foot, which is higher than the 1997/1998 weighted average of actual rents, accounting for some of the actual leases being older and below market. He used market operating expenses of $7.75 per square foot, which are similar to the actual expenses. They are higher than those reported expenses in the *Building Owners and Managers Association* (*BOMA*) *Report* due to owner office expenses; the owner maintains a corporate office in the property. His rounded deferred maintenance expense came from the 1998 operating budget, not actual expenses.

11. Mr. Poling calculated leasing and TI costs by using a 30% tenant turnover based on surveys of their other clients.

12. Mr. Poling testified that the tax rate needed changed in his report to 3.59%, and the overall rate should be reduced to 8%. His corrected composite overall capitalization rate should be 11.59% rounded to 11.6%. This would increase his value conclusion to $24,600,000.00.

13. Mr. Poling testified that the major difference between his and Respondent’s income approach calculations are in the expenses, particularly the TI and leasing expenses.

14. Based on the market approach, Petitioner's witness presented an indicated value of $23,641,700.00 for the subject property.

15. Petitioner's witness presented 4 comparable sales ranging in sales price from $66.29 to $88.05 per square foot and in size from 87,489 to 133,314 square feet. After adjustments were made, the sales ranged from $65.66 to $78.76 per square foot.

16. Mr. Poling testified that his sales comparables were obtained from *CoSTAR COMPS*. He independently verified all of the comparables with the exception of Comparable #2; his call was not returned, but he accepted *COMPS* confirmed data.

17. Mr. Poling testified that he adjusted the sales for time, location, size, age, and land-to-building ratio; he did not adjust for parking ratios. He relied most upon Comparable #4.

18. Mr. Poling testified that the subject property sold in May of 1996 for $23,500,000.00. He time adjusted the sale using 1% per month and arrived at an adjusted sales price of $29,960,000.00.

19. Mr. Poling gave all weight to the income approach, as that is what an investor would consider.

20. Under cross-examination, Mr. Poling admitted that his deferred maintenance cost was from a budget, not an actual expenditure. He believes the *BOMA* figures are understated due to the efficiency of the Lee operated buildings that are included in the report. The base year data collection period is January 1, 1997 through June 30, 1998. The leases shown on page 10 are only base period leases. He did not include other income in his analysis and admitted that the actual other income received for the subject was significant enough to change the value. He did a fee simple analysis. He explained his built-up mortgage equity capitalization rate technique; he did not know if it accounted for property management. He attempted to extract a capitalization rate from the sales. His information on page 14 of his analysis is projections forward past January 1, 1999, using base year data. The *Korpacz Survey* does not cover the Denver market.

21. Under cross-examination, Mr. Poling testified that his adjustments in the market approach were qualitative in nature. The comparable sales' asking rents were all lower than the subject's rents, but he did not make a quality adjustment as these were asking rents and he could not verify what the actual rents were. He did not make a location adjustment to Comparable #2, even though it was located in a different sub-market. He agreed that Comparables #2 and #3 were part of a bulk sale, and that the value is allocated; however, he feels they represent market value based on his professional judgment. He admitted that some of the reported subject property capital expenses were probably used for the corporate office of the owner and were not deferred maintenance. He did not use a reserve for replacements in his analysis; he used deferred maintenance, as that is what an investor would use. He did not appraise the assessor comparables that he presented in his report and could not verify that they were properly valued by the assessor.

22. Upon questioning by the Board, Mr. Poling testified that he had confirmed with his client that the actual 1996 purchase price of the subject property was $23,500,000.00.

25. Petitioner is requesting a 1999 actual value of $24,600,000.00 for the subject property.

26. Respondent's witness, Mr. Corbin Sakdol, a Certified General Appraiser with the Arapahoe County Assessor's Office, presented the following indicators of value:

Market:	$37,700,000.00
Income:	$35,150,000.00

27. Mr. Sakdol testified that the subject property is a high quality office building located in Greenwood Plaza and is a multi-tenant complex. The gross building area is 340,880 square feet, with a net rentable area of 327,956 square feet. This is a highly desirable area. It is a class A or B property.

28. Respondent's witness did not calculate a cost approach, as it was considered not to be reliable unless the improvement was new. There was sufficient data to conclude to a market and income approach to value.

29. Based on the market approach, Respondent's witness presented an indicated value of $37,700,000.00 for the subject property.

30. Respondent's witness presented 4 comparable sales ranging in sales price from $101.36 to $132.35 per square foot and in size from 162,817 to 353,706 square feet. After adjustments were made, the sales ranged from $102.47 to $139.63 per square foot.

31. Mr. Sakdol testified that he reviewed over 30 office building sales. He chose his four comparable sales based on their being the most similar in size and age to the subject. All of the sales were verified using the assessor form, TD1000. He described the sales and testified that all of the sales have excellent access. He used a 1.1% time adjustment based on a study of paired sales. His physical characteristic adjustments were qualitative in nature. Factors considered included rentable building area, age, condition, design, quality, parking, land-to-building ratio, and building class. He also felt that a good measure of comparability was asking rents, as listed in *Black's Guide*.

32. Respondent's witness used the income approach to derive a value of $35,150,000.00 for the subject property.

33. Mr. Sakdol testified that he removed both the storage and conference areas from the buildings' total square footage to arrive at a net rentable area of 327,956 square feet. Page 37 of his report is the actual rent roll for the subject buildings. The leases listed in blue are leases signed during the base year. He used a market rent of $18.00 per square foot. He included other income in his analysis, such as parking income. He used a vacancy rate of 5.5%, obtained from the *ROSS* report.

34. Mr. Sakdol testified that he used *BOMA* expenses to arrive at a market operating expense rate of $4.58 per rentable square foot, excluding real estate taxes. The owner expenses not reflected in the operating expenses include leasing commissions, tenant improvements, and capital reserves. When using a market capitalization rate, theses expenses fall after net operating income. If they were included, there would need to be an equity capitalization rate, which would be lower than an overall rate. He presented various capitalization rate studies and testified that

he gave the most weight to the market extracted capitalization rates confirmed by *COMPS* and gave secondary weight to market capitalization rates extracted from actual discounted cash flow analysis. He concluded to a non-tax loaded overall capitalization rate of 7.75%. He used a tax rate of 3.59%, for a tax loaded overall capitalization rate of 11.34%.

35. Mr. Sakdol testified that he gave equal weight to both the market and income approaches, and concluded to a value of $36,400,000.00 for the subject property for tax year 1999.

36. Mr. Sakdol testified that Petitioner's Comparable Sales #2 & #3 in the market approach were allocated values. He confirmed that the allocated values were not market values, but part of a bulk sale with an "off the seat of their pants" value.

37. Under cross-examination, Mr. Sakdol clarified that his Sale #1 is located in Denver County, which has a lower mill levy, resulting in lower expenses. He admitted that this sale is located closer to the central business district, but he did not believe that the location would add any additional value. He believes it was part of a bulk sale. Sale #2 had a capitalization rate of 8.8%. It is smaller, involved a REIT, and was a bulk sale, but was not an allocated price; the sales price was determined through a discounted cash flow analysis. Sale #3 has a marble exterior, which is very expensive; he adjusted for design and construction quality. Sale #4 was also a REIT and bulk sale. It was considerably smaller than the subject property, but he did not adjust for size; he feels size is not a consideration for a buyer. He gave most weight to Sale #4.

38. Mr. Sakdol testified that fee simple capitalization rates do not exist, as there are always leases in existence. The tenant finish and commissions were not considered in the appraisal. Regarding time adjustments, in his research a 1% versus a 1.1% would not make much of a difference in the concluded value.

39. Respondent assigned an actual value of $30,000,000.00 to the subject property for tax year 1999.

40. Respondent's witness, Mr. Burton Lee, MAI, a Certified General Appraiser, testified regarding capitalization rate methodology. He testified that both parties' approaches are acceptable, but the methodology must be applied consistently. The most typical methodology is to deduct the TI's and commissions after the net operating income. He does not believe there is market support for Mr. Poling's capitalization rate calculation.

41. In rebuttal, Mr. Poling testified that he believes size is a factor in rent.

CONCLUSIONS:

1. Respondent presented sufficient probative evidence and testimony to prove that the subject property was correctly valued for tax year 1999. Mr. Sakdol presented a well-organized and well-supported appraisal report.

2. Both parties gave little credence to the cost approach due to the age of the property and the availability of arriving at a value conclusion using the other two approaches. The Board agrees that the cost approach is the least applicable approach to the subject property.

3. Both parties calculated a market approach, but both were successful in pointing out flaws in each other's market sales and adjustment calculations. Therefore, the Board gave little weight to the market approach conclusions of either party.

4. Both parties gave the most weight to the income approach, and the Board concurs that this would be the best approach with which to value the subject property.

5. After careful examination of all the evidence and testimony, the Board was more persuaded by the methodology and value conclusion of Respondent's witness, Mr. Sakdol.

6. Mr. Poling used a mix of actual and budgeted expenses. He admitted that his deferred maintenance costs were budget figures projected for 1998, not actual expenditures. He admitted that some of the reported subject property capital expenses were probably used for the corporate office of the owner and were not deferred maintenance. He also admitted that he did not include "other income" in his analysis and admitted that the actual "other income" received for the subject property was significant enough to change the value conclusion. He did not know if his built-up mortgage equity capitalization rate technique accounted for property management.

7. Mr. Poling and Mr. Sakdol differed most in their income valuation presentations in their treatment of tenant finish, leasing commissions, and deferred maintenance expenses. Mr. Poling expensed these items. However, this Board has consistently ruled that for property tax purposes, the preferred method for accounting for tenant finish and leasing commissions is to reflect these expenses in the overall capitalization rate, not deduction as expenses. Respondent's overall capitalization rate was well supported in the appraisal report. Regarding the deferred maintenance expense, notes in Respondent's report indicated that there was no significant deferred maintenance observed during the physical inspection. Mr. Poling's deferred maintenance cost was based on budgeted amounts, not actual expenditures.

8. As to the equalization issue, Mr. Poling testified that he did not appraise the assessor's comparables that he presented in his report and could not verify that they were properly valued by the assessor. The Board finds that there was insufficient data presented to support Petitioner's claim that the subject property was valued differently than other similar properties located within the county.

9. The Board affirms Respondent's assigned value of $30,000,000.00.

ORDER:

The petition is denied.

APPEAL:

Petitioner may petition the Court of Appeals for judicial review within 45 days from the date of this decision.

If Respondent alleges procedural errors or errors of law by this Board, Respondent may petition the Court of Appeals for judicial review within 30 days from the date of this decision.

DATED and MAILED this 27th day of September, 2001.

BOARD OF ASSESSMENT APPEALS

Karen E Hart

Karen E. Hart

Judee Nuechter

Judee Nuechter

Debra A. Baumbach

Debra A. Baumbach

This decision was put on the record

SEP 26 2001.

I hereby certify that this is a true and correct copy of the decision of the Board of Assessment Appeals.

Diane Von Dollen

Diane Von Dollen

STATE OF COLORADO SEAL BOARD OF ASSESSMENT APPEALS

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