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| **BOARD OF ASSESSMENT APPEALS,**<br>**STATE OF COLORADO**<br>1313 Sherman Street, Room 315<br>Denver, Colorado 80203<br><br>Petitioner:<br><br>**DMV SUB 4 LLC,**<br><br>v.<br><br>Respondent:<br><br>**BROOMFIELD COUNTY BOARD OF EQUALIZATION.** | |
| Attorney or Party Without Attorney for the Petitioner:<br><br>Name: Alan Poe, Esq.<br>Holland & Hart LLP<br>Address: 8390 East Crescent Parkway, Suite 400<br>Greenwood Village, Colorado 80111<br>Phone Number: (303) 290-1616<br>E-mail: apoe@hollandhart.com<br>Attorney Reg. No.: 7641 | **Docket Number: 39674** |

# ORDER

**THIS MATTER** was heard by the Board of Assessment Appeals on October 29, 2002, Judee Nuechter and Karen E. Hart presiding. Petitioner was represented by Alan Poe, Esq. Respondent was represented by Tami Yellico, Esq., Broomfield Deputy City and County Attorney.

## PROPERTY DESCRIPTION:

Subject property is described as follows:

**Interlocken #1 Replat, Blk 1, Lot 3,**
**Known as 310 Interlocken Parkway**
**(Broomfield County Schedule No. 1575-330-04-003)**

Petitioner is protesting the 2001 actual value of the subject property, the McData Building, a commercial office building located at 310 Interlocken Parkway in Broomfield, Colorado.

## ISSUES:

### Petitioner:

Petitioner contends the subject property was overvalued. The subject property is an office and research and development facility. It is an investment property that should be valued based on the income it generates.

### Respondent:

Respondent contends the subject property was properly valued for the tax year based on a 123,000 square feet building located on 7.867 acres within the Interlocken Parkway and based on reported income as of June 30, 2000. All three approaches to value were considered by the Respondent in valuing the subject property. The compelling indicator was a $16,800,000.00 sale price in 1999 of the subject property, which occurred during the base period. Additionally, there was record growth from January 1, 1999 to June 30, 2000 in the market, which was considered in valuing the property.

## FINDINGS OF FACT:

1. Petitioner's witness, Mr. James R. Burbach, MAI, Director, Integra Realty Resources-Denver, presented the following indicators of value:

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| Market: | $13,555,000.00 |
| Income: | $12,555,000.00 |

2. The witness testified that the subject property is located approximately 14 miles northwest from the Denver business district, at 120th Avenue and Interlocken Parkway. The subject site is 7.867 acres with a rentable building area of 121,970 square feet. There is some warehouse storage area, loading dock, and office and research areas. The building is of masonry construction. There are temporary interior office cubicles with most of the office areas being open space. Cubicle breakdowns are not typical in today's office buildings. There are a number of meeting rooms for software development and for training outside groups as well as their own employees. Interior finish is the same as it was in 1986 when the building was new and is considered obsolete based on the open office space and raised floors in the computer rooms. The building was designed for single-tenant occupancy. It is more difficult to lease a 122,000 square foot building today to a single tenant. Conversion for multi-tenant occupancy would be costly. McData has been the only tenant since 1988 when the building was completed.

3. The witness toured the subject property on June 17, 2002 with the Facilities Manager of McData. He performed a retrospective appraisal and looked at the lease income, expenses and capitalization rates from the base period. The subject property is considered an investment property

for the valuation process. He analyzed market reaction for investment properties such as stabilized vacancy, comparable sales, and leases. The primary valuation method is the income approach and the secondary is the market approach. The cost approach is seldom used. The witness testified that he relied on the direct capitalization method in determining the value for the subject property. He did not consider the lease as that would result in a leased fee interest, not a fee simple interest.

4. Based on the market approach, Petitioner's witness presented an indicated value of $13,555,000.00 for the subject property.

5. Petitioner's witness presented five comparable sales ranging in sales price from $6,430,000.00 to $17,553,000.00 and in size from 40,179 to 121,970 square feet. After adjustments were made, the sales ranged from $116.22 to $126.72 per square foot. Sale 5 is the subject property.

6. The sales presented by the Petitioner had significant physical differences due to age and degree of office finish. It was difficult to make adjustments based on square foot measurements. The price per square foot comparison was based on the Net Operating Income (NOI) of the comparable sales as compared to the subject property. The differences would be indicated in the price per square foot based on the market.

7. Sale 5, which is the subject property, was used in the Petitioner's report because it occurred within the base period. The Petitioner's witness indicated there were other circumstances outside the transaction that determined the sale price of the subject property. The chief investment officer that represented the buyer of the subject property indicated to the witness that the transaction was part of nine properties within a portfolio sale with some of the properties located in other states.

8. The Petitioner's witness testified that he expanded the neighborhood to find market rents for larger size buildings similar to the subject property. He used a net operating income approach, which is more applicable than a square foot comparison. The sale of the subject property in January 1999 was higher than the sales price range, and it was part of a nine-property portfolio sale. The purchase price was an allocation. Mr. Burbach indicated that he adjusted the sales based on the percent difference in the net operating income of the sales as compared to the subject. He used $120.00 per square foot for a value of $14,635,000.00. He then made an adjustment for recognizing additional tenant finish costs if the current tenant leaves, indicating an adjusted value of $13,555,000.00 for the sales comparison approach.

9. Based on the income approach, Petitioner's witness presented an indicated value of $12,555,000.00 for the subject property.

10. The witness indicated that the comparable properties he reviewed for determining market rent had long-term leases with larger size buildings. There were 11 leases in place during or before the base period with 5-, 10-, or 20-year terms. All were single-tenant leases except one. He had to go outside the area for these leases, which is typical. An investor is typically not interested in the location, only the return on his investment. Most of the buildings were newer than the subject and he felt that the subject property could not compete with the other buildings due to inadequate tenant finish such as 13- to 15-year old carpeting, high ceilings, office cubicles and minimal private offices. An additional investment for upgrades would be necessary to compete with the comparable sales, resulting in an adjustment made to both approaches in the report to make the subject

competitive. Market rent would be indicated at $13.50 a square foot on a net basis after the upgrades since all of the comparable sales were newer buildings.

11. Mr. Burbach used the Ross Vacancy Study for Offices to determine a 12 percent average vacancy for the base period. The witness deducted the owner expenses for the vacancy period and concluded to $7.00 a square foot total expense, based on periods of vacancy for the 121,970 square foot rentable area. A capitalization rate of 10 percent was determined from sales and surveys. The indicated value was $13,635,000.00 without consideration of the condition of the property. He then reduced that value by $2.00 per square foot for the condition of the improvements and to allow the subject to be competitive in the marketplace. He also deduced $1.00 per square foot per year for brokerage commissions, deriving a final "as is" value of $12,555,000.00 via the income approach for the subject property.

12. Petitioner's witness indicated that the cost approach was not used in this report. Once a building is constructed and available, a potential investor is interested in the income approach and does not use the cost approach as a primary approach to value.

13. Under cross-examination, the witness testified that to encourage a tenant to remain or obtain a new tenant, improvements would have to be made to the subject. A new tenant may not directly incur the cost of improvements, but they may be built into the lease. The owner must anticipate paying for these improvements.

14. The witness testified under cross-examination that three of the properties were newer than the subject property and would require less maintenance. These properties could generate more income and were less risk to the owner than the subject property. The capitalization rates of the comparable sales were lower than that used for the subject property based on their desirability and higher rents as well as the condition of the improvements.

15. During cross-examination, the witness testified that the Boulder-Interlocken market area is approximately 50 percent of the northwest corridor vacancy study. The vacancy rate from within the jurisdictional area of the City of Broomfield was provided by the Broomfield County Assessor's Office; vacancy rates from more narrowly established lines may or may not be more representative of the subject's market.

16. During redirect, the witness testified that the sales occurred during or before the base period and the leases were entered into before or during the base period up to June 30, 2000.

17. Petitioner is requesting a 2001 actual value of $13,500,000.00 for the subject property.

18. Respondent's witness, Mr. John W. Storb, a Certified General Appraiser in Colorado and a commercial appraiser with the Broomfield County Assessor's Office, presented the following indicators of value using all three approaches to value:

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| Market: | $16,400,000.00 |
| Cost: | $10,797,300.00 |

Income: $14,480,000.00

19. The witness testified that although all three approaches to value were used in his report, the cost approach is least influential due to the age of the subject. Typically, investors do not consider this approach. The most weight was given to the market approach with consideration of the subject property being sold within the base period.

20. Based on the market approach, Respondent's witness presented an indicated value of $16,400,000.00 for the subject property.

21. Respondent's witness presented 2 comparable sales ranging in sales price from $6,430,000.00 to $16,800,000.00 and in size from 41,832 to 123,457 square feet. After adjustments were made, the sales ranged from $122.96 to $136.08 per square foot. One of the sales was the subject property, which sold on January 15, 1999.

22. The witness presented no adjustments to the subject property in the market approach. The other comparable sale was adjusted for size, age and use; it was entirely office space with no warehouse space.

23. Respondent's witness used a state-approved cost estimating service to derive a market-adjusted cost value of $10,797,300.00 for the subject property.

24. Mr. Storb testified that a land value of $8.55 per square foot was determined from land sales within the Interlocken Parkway area. Values for characteristics such as asphalt paving, canopy and sprinkler system was determined from *Marshall Valuation Service*. A depreciation cost of $7,303,000.00 was based on physical depreciation. The least weight was given the cost approach due to the age of the subject building.

25. Mr. Storb testified that the subject has been leased since June 1998 at $12.20 per square foot on a triple net lease. The two comparables shown in the income approach were leased at $11.70 and $14.00 per square foot with triple net leases and both were located in the Interlocken Parkway. A 5 percent vacancy rate was used in his report, although the City of Broomfield indicated a 1 to 3 percent vacancy rate during the base period. Competing neighborhoods such as the Denver Tech Center (DTC) and Inverness were comparable in vacancy rates. The expenses for the subject property used in his report were obtained from the owner. Mr. Storb added a 2 percent reserve for items such as HVAC, roofs, et cetera, based on the age of the subject building. A 9.5 percent capitalization rate was determined based on an investment survey, which showed a range of 9 percent to 11 percent. The capitalization rate was below the median rate of 10 percent based on the low vacancy rate and growth in the area.

26. The witness testified that the income approach is typically used to establish value for a buyer with consideration of the building characteristics. This ultimately determines value. The market approach is strong due to the sale of the subject property. The income approach was considered using typical information rather than actual information. Most weight was given to the market approach, which was reconciled to $15,920,000.00 for the subject property. The value assigned to the subject property is $15,800,800.00.

27. The witness testified that future tenant improvements and commissions were not included in his report per Division of Property Taxation regulations. The subject property has been fully leased by McData for fifteen years. Leasing commissions are not considered as an expense for ad valorem taxation. Tenant improvements and commissions for the subject property would occur after the base period.

28. The witness testified that the Broomfield Economic Development Corporation statistics are a tool to promote and retain jobs in Broomfield based on a monthly survey they publish. Office space under construction is not included in this survey until the county building department issues a certificate of occupancy. Based on this survey, the Broomfield total vacancy was 1.12 percent for office space available in January 1999. January 2000 had a space available rate of 3.27 percent. July 2000 had less than a 1 percent occupancy rate. A total of 1,920,000 square foot of office space was added in eighteen months creating lower vacancy rates and indicating a strong market in Broomfield during the base period. He feels this survey is more reflective than the northwest submarket corridor as presented by the Petitioner, which included over 100 square miles. The Interlocken Parkway market is only several square miles in size.

29. Based on testimony by the witness, the subject property had a 2000 net operating income of $1,546,692.98, or a 9.21 percent capitalization rate based on the 1999 sale price of the subject. This figure is similar to the capitalization rate indicated by Comparable Sale 1 in the Petitioner's report and not the 10 percent that the Petitioner used in his report. All of the comparable sales used by the Petitioner were leased fee sales including the subject property.

30. Mr. Storb testified that the $11.18 per square foot comparison for the subject property in the Petitioner's appraisal report is based on $13.50 per square foot market rent and then adjusted at the 12 percent vacancy rate and the related expenses of vacancy. Using the actual net operating income of the subject in 2000 with the actual sale price in 1999, a different conclusion of $16,525,000.00 is indicated.

31. Under cross-examination, the witness testified that the interest to be valued is fee simple and not a leased fee, which could be more or less determined by the leased properties. He did not adjust the subject sale for being a leased fee and he was not aware that the subject property was part of a portfolio sale.

32. The witness testified under cross-examination that he gave the market approach the most weight with some consideration from the income approach and adjustments must be made to the comparables.

33. Mr. Storb testified that buyers are typically motivated by the income stream. Income streams must have adjustments made for each sale. The sale of the subject was a leased fee sale, not a fee simple sale and it was sold subject to the encumbrances. He did not make an adjustment for the leased fee and neither did the Petitioner's witness.

34. Mr. Storb admitted under cross-examination that his income approach is based on a leased fee, not a fee simple estate. His rental data was not derived from the market but from the subject since he did not have eighteen-month market rental data available. The vacancy rate that he used from the Broomfield Economic Development Corporation survey did not include available

subleased space. He agreed that the survey was used to promote economic development in Broomfield.

35. The witness testified under cross-examination that he used the lower capitalization rate in his appraisal report due to the property being fully leased and a strong local market.

36. Mr. Storb testified that two income approaches were indicated in his appraisal report. The first one used actual data and the second one used hypothetical calculations.

37. During recross-examination, the Respondent's witness indicated that he gave no deductions for owner expenses during vacancies or for owner costs to update the property.

38. Respondent's Witness, Mr. Kevin Standbridge, Assistant City and County Manager of Broomfield Economic Development Corporation, testified that during the base period he assisted in gathering information regarding rents, space available, and the general condition of business space in the City of Broomfield for potential business contacts. He testified that the City of Broomfield relied on this data for city planning.

39. Under cross-examination, the witness testified that based on potential office space under construction in the market area during the base period, the subject property would be competing with these areas for available space.

40. Respondent's witness, Ms. Nancy Anders, Broomfield City and County Assessor, testified that she was concerned with the vacancy rate used by the Petitioner. She indicated that he appears to have selectively chosen vacancy rates, square footage lease rates, and expenses. The northwest corridor vacancy rate was shown at 12 percent while the rental market rates came from the entirety of the Denver area. She believes the Interlocken Parkway would be more similar to the southwest Denver market. The rental data needs to be from the same area as the vacancy rates. Southwest Denver had a vacancy rate of 4.6% per the Ross Report. This report showed a midyear vacancy rate of 7.2 percent and capitalization rates were less than 10 percent for the Interlocken marketplace. She believes investment properties as of June 30, 2000 were strong in this area. She does not believe future commissions and leasing costs are allowed in determining taxable value.

41. Under cross-examination, the witness testified that she did not conduct any other research for leases other than the Ross Report. Also, if the subject property's tenant improvements were in below average condition, it would be considered in the appraisal.

42. The Respondent assigned an actual value of $15,800,800.00 to the subject property for tax year 2001.

43. During rebuttal testimony, Mr. Burbach indicated that the $13.50 per square foot market rent came from rental comparables, not surveys. The vacancy rate should be based on the neighborhood for a stabilized rate. This is also based on the age of the subject and historical levels and not as of a particular date. He indicated that he felt approximately 50 percent of the northwest corridor was U.S. Highway 36, which is considered the Interlocken Parkway area.

## CONCLUSIONS:

1. Petitioner presented sufficient probative evidence and testimony to prove that the tax year 2001 valuation of the subject property was incorrect.

2. Considering the age and condition of the subject property, the Board gave the least amount of weight to the cost approach.

3. Both the Petitioner and the Respondent agree that the subject property is an investment property and it would typically be bought and sold on an income basis. Therefore, both parties considered the income approach to be a good indicator of value and the Board agrees.

4. The Net Operating Income (NOI) for the subject property as determined by the Petitioner and by the Respondent was similar; the Respondent calculated $1,375,735.00 and the Petitioner calculated $1,363,625.00.

5. The Capitalization rate determined by the Respondent was 9.5 percent based on an investment survey, while the Petitioner used a 10 percent rate as typical of the marketplace. The Petitioner and the Respondent further disagree whether additional reductions for the condition of the subject property due to its age are appropriate. The Board determined that Respondent's capitalization rate of 9.5% was the more appropriate rate for the subject property.

6. The Board was convinced that the northwest corridor marketplace was too broad an area to use in determining vacancy rates. Based on testimony, the Interlocken Parkway area had significantly lower vacancy rates than the broader area used by the Petitioner. The Board was convinced that Respondent's 5% vacancy was more appropriate for the Interlocken area.

7. This Board has consistently ruled that leasing commissions are not allowable expenses for ad valorem taxation. Tenant improvements are considered to be capital expenses and not operating expenses. Additionally, the Board must consider the value of the subject property as of June 30, 2000. Petitioner's deduction of anticipated future tenant improvements is going beyond the level of value date. Therefore, the Board did not believe a deduction of these expenses was appropriate.

8. The Board used Petitioner's Effective Gross Income, after adjustment to a 5% vacancy rate, of $1,564,265.00. The Board then deducted Petitioner's ownership expense during vacancy, reduced to reflect a 5% vacancy rate, which calculated to $42,690.00. The Board then used Respondent's capitalization rate of 9.5% and calculated an indicated value of $16,016,579.00 for the subject via the income approach.

9. Regarding the market approach, the subject property sold in January 1999, during the base period, but was part of a Real Estate Investment Trust (REIT) or portfolio sale; and therefore, the Board was convinced that the sale price as indicated in county records may be an allocated price and not an actual sale price. The Board does not consider this a good comparable in determining value by the market approach.

10. The Board considered Respondent's second sale, which adjusted to $122.96 per square foot and notes that Petitioner's market approach concluded to $120.00 per square foot. The Board affirms Petitioner's market value conclusion of $14,635,000.00, without further adjustment for future tenant improvements and leasing commissions.

11. Giving equal weight to each approach, the indicated value of the subject property is $15,325,790.00.

12. After careful consideration of all the evidence and testimony presented, the Board concluded that the 2001 actual value of the subject property should be reduced to $15,325,790.00.

## ORDER:

Respondent is ordered to reduce the 2001 actual value of the subject property to $15,325,790.00.

The Broomfield County Assessor is directed to change her records accordingly.

## 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 ____ day of December, 2002.

**BOARD OF ASSESSMENT APPEALS**

**DATED and MAILED** this 13th day of December, 2002.

**BOARD OF ASSESSMENT APPEALS**

Karen E. Hart

Karen E. Hart

Judee Nuechter

Judee Nuechter

This decision was put on the record

DEC 1 3 2002.

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

Penny S. Lowenthal

Penny S. Lowenthal

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