BOARD OF ASSESSMENT APPEALS, **STATE OF COLORADO** 1313 Sherman Street, Room 315 Denver, Colorado 80203 ______________________________ Petitioner: **RMC/PAVILION TOWERS LLC,** v. Respondent: **ARAPAHOE COUNTY BOARD OF EQUALIZATION.**	
Attorney or Party Without Attorney for the Petitioner: Name: Thomas E. Downey, Jr., Esq. Downey & Knickrehm, PC Address: 733 East 8th Avenue Denver, Colorado 80203 Phone Number: (303) 813-1111 Attorney Reg. No.: 9686	**Docket Number: 41530**

ORDER

THIS MATTER was heard by the Board of Assessment Appeals on July 12, 2004, Diane M. DeVries, Sondra W. Mercier, and Karen E. Hart presiding. Petitioner was represented by Thomas E. Downey, Jr., Esq. Respondent was represented by George Rosenberg, Esq.

PROPERTY DESCRIPTION:

Subject property is described as follows:

2821-2851 S. Parker Road, Aurora, Centennial, Colorado
(Arapahoe County Schedule Nos. 1973-35-2-16-001 and 1973-35-2-16-002)

Petitioner is protesting the 2003 actual value of the subject property; two, 14-story multi-tenant office buildings built in 1980, located on a 10.51-acre site in Aurora, Colorado. The gross building area is 334,416 square feet, with a net rentable area of 291,096 square feet.

ISSUES:

Petitioner:

Petitioner contends that the subject property has been overvalued using the income approach to value. Respondent overstated the rental rate by not considering market rental rates. Respondent only considered the subject property's actual rental rates and competing properties' asking rents.

Respondent:

Respondent contends that the subject property has been properly valued using the income approach. The best indicator of market rental rates is the subject property leases that were let during the base period.

FINDINGS OF FACT:

1. The subject property, known as the Pavilion Towers, is classified as Class A/B quality construction and is in good condition. The gross building area is 334,416 square feet, with a net rentable area of 291,096 square feet. There is an unobstructed view from the primary thoroughfares and the property has good access. The subject is located in the southeast suburban market area.

2. Neither party prepared a cost approach. Petitioner did not prepare a market approach. Respondent prepared a market approach, but gave it no weight in the value conclusion. Both parties relied upon the income approach to value. Within the income approach, the parties stipulated to a vacancy rate of 24%, expenses of $2,080,482.00 including real estate taxes of $518,606.00, and an overall capitalization rate of 12.39%.

3. The base period for tax year 2003 is January 1, 2001 through June 30, 2002. The subject was 49% vacant on the assessment date, January 1, 2003.

4. Petitioner's witness, A. Mark Dyson, MAI, CCIM, and Certified General Appraiser with DYCO Real Estate, Inc., presented an income approach to derive a value of $14,200,000.00 for the subject property.

5. Mr. Dyson testified that he inspected the subject property. The subject property has an atypically small floor plate, which makes it difficult to attract larger tenants; large tenants do not typically rent multiple floors. The purpose of the appraisal was to estimate the value of the property using base period data for property tax purposes. The appraisal was for fee simple estate, which

assumes that there are no contractual obligations to any tenants, and that the property is operating at typical market rental rates, vacancy rates, and operating expenses.

6. The subject neighborhood is typical in that it is convenient to the Denver Tech Center, near Interstate 225, has many commercial properties, and is a diverse and well-rounded neighborhood. The office properties in the area experienced high vacancy during the base period. The subject neighborhood had lower rental rates and higher vacancies than were typical in the southeast Denver market.

7. The current owner purchased the subject property for $23,440,000.00 on June 30, 2000. The owner was notified early in 2002 that 40% of the building was going to become vacant. In an effort to keep the AMR tenant, in April 2002 the property owners offered a base rental rate of $14.00 per square foot, with an average rate of $11.00 over the 10-year lease period, and an effective rate of $8.50 per square foot after other incentives. AMR did not accept the offer and vacated the space.

8. Mr. Dyson used direct capitalization for his income approach. To determine the rental rate, he analyzed comparable properties in the area and actual property data. He focused on 2002 lease data, as the market was rapidly trending downward. The subject property's new leasing activity was dropping off and there were few new leases in 2002. He was looking for the effective rental rate after adjustment for incentives such as free rent and tenant improvements. The weighted average effective rental rate was $14.72 per square foot. The two most competitive properties, Petitioner's Rental Comparables 4 and 5, were already at 40% vacancy, with face rental rates of $17.00 to$18.25 per square foot in the most competitive buildings. There were many subleases that were undermining the lease market. He also conducted interviews with leasing brokers. He determined a market rental rate of $14.75 per square foot.

9. Regarding other income, Mr. Dyson projected parking lot income of approximately $24,540.00, though he would now consent to using the $60,000.00 other actual income figure, which includes sources other than the parking lot income. He arrived at a fee simple value opinion of $14,200,000.00 for the subject property. The change in value from the appraisal report conclusion of $13,880,000.00 is solely a result of the increase in other income to $60,000.00.

10. In cross-examination, Mr. Dyson testified that he considered only market data, not the subject data. He admitted that other leases for the subject were let during the base period, but he did not include them in the appraisal. He did not believe that 2001 data was useful due to the rapidly declining market. Leases executed in 2001 should be adjusted for market conditions to trend to a June 30, 2002 date. The witness indicated that the fairest approach would be to utilize leases that were executed as close to the end of the base period as possible. The best way to determine rental rates is to survey the competing buildings. He also uses CoStar for real time data. He deducted tenant improvements, which are a landlord capital expense. He reduced the actual rent by a calculation of the tenant improvement expense per square foot divided by the term of the lease. The Wells Fargo Mortgage lease was further reduced by the 3-month free rent incentive.

11. Mr. Dyson admitted that Petitioner's Rental Comparables 1, 2, 6, and 7 are substantially smaller than the subject property. The top of the effective rent range is $16.95 per square foot, which if used, would result in a value of $17,810,000.00.

12. In redirect, Mr. Dyson testified that the subject's $16.95 per square foot rental rate is a renewal lease. Ideally, he would use new rental rates and not renewal market rates, as moving expenses are considered by the lessee in the renewal negotiations. Given the size of the individual subject buildings, as compared to the total combined square footage of the subject's two buildings, it is appropriate to consider the rental rates of smaller buildings.

13. Petitioner is requesting a 2003 actual value of $14,200,000.00 for the subject property.

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

Market:	$16,450,000.00
Income:	$17,800,000.00

15. Although Respondent's witness prepared a market approach, he placed no weight on it in the final reconciliation of value.

16. Respondent's witness used the income approach to derive a value of $17,800,000.00 for the subject property.

17. Mr. Sakdol testified that he valued the fee simple interest of the subject property. The primary difference between Respondent's income approach and Petitioner's is the rental rate. Using Petitioner's calculations for everything but the rental rate, and using Respondent's concluded $18.00 per square foot rent rate results in a value of $19,684,969.00.

18. Mr. Sakdol testified that the best indicators of market rental rates are leases signed in the base year. There were 16 subject property leases signed during the base period, which ranged from $15.36 to $19.50 per square foot, with a weighted mean of $18.73 per square foot. He recognizes that lease rates were dropping during the base period.

19. Mr. Sakdol testified that he obtained rental information from two other properties in the subject property's area. According to CoStar Property, the reported rental rates ranged from $17.50 to $18.50 per square foot. They relied most on the subject property rental rates from the end of the data-gathering period and concluded to $18.00 per square foot. However, Mr. Sakdol testified that he would be comfortable with a rental rate of $16.95 per square foot, the high end of the rental range presented by Petitioner.

20. Under cross-examination, Mr. Sakdol testified that Arapahoe County relies heavily on the Fredrick Ross report. The Ross report shows that rental rates trended downward by 10 percent or more from the end of 2001. He agrees that a 24% vacancy rate indicates a down market.

In such a market, the landlords are motivated, may provide more tenant finish, and may negotiate to pay more tenant commission. He does not adjust base rates for landlord incentives. All but three of the subject leases shown on page 40 of Respondent's Exhibit 2 are from 2001; the remaining leases are from 2002. Of the 2002 leases, one was a renewal, one was an expansion by an existing tenant, and one was a new lease. The weighted mean lease rate of $18.73 per square foot is prior to an adjustment for time. He believes he accounted for time by choosing rental rates from the end of the base period. He agreed that sublease space pulls lease rates down.

21. In redirect, Mr. Sakdol testified that he considered the subject lease information to be market rates as tenants negotiate and rates are reflective of competing properties, so long as it is not sublease space. Respondent's subject lease information came from the actual rent roll dated June 2002. It is clear that there was a downward trend in the lease rates. He reminded the Board that the Ross report covers a large area; the subject's rental rate trend is more accurate.

22. Respondent assigned an actual value of $20,000,000.00 to the subject property for tax year 2003, but is recommending a reduction to $17,800,000.00.

23. In rebuttal, Petitioner's witness, Mr. Dyson, testified that he views the Ross report as a good source for overall trends. If a property is not following the Ross trends, he then researches further. He believes market rent is significantly lower than Respondent's rental rate of $18.00, which makes no deduction for free rent or incentives. He pointed out that Respondent's CoStar rentals are asking rents, not actual rents. From year-end 2001 to mid-year 2002, the rental rates went down by 10%. Therefore, the rents should have been trended by at least 10%.

24. In cross-examination, Mr. Dyson admitted that three of the four leases shown on page 34 of Respondent's Exhibit 2 are renewal leases.

CONCLUSIONS:

1. Sufficient probative evidence and testimony was presented to prove that the tax year 2003 valuation of the subject property was incorrect.

2. The Board agrees with both parties that the income approach is the most appropriate approach to value for the subject property. Furthermore, the Board accepts the stipulated vacancy rate of 24%, expenses of $2,080,482.00 including real estate taxes of $518,606.00, and the overall capitalization rate of 12.39%. The only component that is in dispute is the rental rate.

3. The Board examined the leases at the subject property and notes that the majority of the leases were let in 2001. Both parties agree that there was a downward trend in rental rates during the data-gathering period. Respondent's original rental rate of $18.00 does not appear to adequately reflect this downward trend. Trending Respondent's rental rate by a negative 10% results in a rate of $16.20 per square foot. Respondent agreed to reduce the rental rate to $16.95, based on Petitioner's subject lease #4, the Excel Personnel lease.

4. Petitioner used a rental rate of $14.75, which was based on four subject property

leases, adjusted for tenant improvement expenses and other landlord concessions. Tenant improvements are capital expenditures that are not considered allowable deductions for property tax purposes. The unadjusted rental rates ranged from $13.00 to $18.50 per square foot. Respondent's agreed to rental rate of $16.95 falls within the range and is slightly higher than the time trended rate of $16.20 as previously calculated on additional subject property leases. The Board also considered the $17.00 to $18.25 asking rates of Petitioner's Comparables 4 and 5, which Petitioner testified were the most competitive properties compared to the subject property. The Board notes that these asking rates would likely be at the upper end of the expected rent range, as asking rents typically tend to be higher than actual rents. The Board determined that a rental rate of $16.95 is reasonable.

5. After careful consideration of all the testimony and evidence presented, the Board concluded that the 2003 actual value of the subject property should be reduced to $17,800,000.00.

ORDER:

Respondent is ordered to reduce the 2003 actual value of the subject property to $17,800,000.00.

The Arapahoe County Assessor is directed to change his/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 23rd day of November 2004.

BOARD OF ASSESSMENT APPEALS

Diane M DeVries

Diane M. DeVries

Sondra W. M

Sondra Mercier

Karen E Hart

Karen E. Hart

This decision was put on the record

NOV 2 3 2004

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

Penny S. Lowenthal

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BOARD OF ASSESSMENT APPEALS

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