

**BOARD OF ASSESSMENT APPEALS,
STATE OF COLORADO**

1313 Sherman Street, Room 315
Denver, Colorado 80203

Docket No.: 55620

Petitioner:

INLAND PPD HUDSON ASSOCIATES, LLC,

v.

Respondent:

WELD COUNTY BOARD OF EQUALIZATION.

ORDER

THIS MATTER was heard by the Board of Assessment Appeals on March 22, 2012, Diane M. DeVries and Louesa Maricle presiding. Petitioner was represented by Thomas E. Downey Jr. Esq. Respondent was represented by Stephanie L. Arries, Esq. Petitioner is protesting the 2010 actual value of the subject property.

Subject property is described as follows:

**3001 North Juniper Street, Hudson, Colorado
Weld County Schedule No. R6775763**

The subject property is the 1,250-bed Hudson Correctional Facility, a privately owned and operated medium security prison in the Town of Hudson, Colorado. According to Weld County records, the facility consists of building improvements with a total of 300,016 square feet situated on approximately 50.774 acres of land. The building improvements include four housing units, an administration/medical support building, storage warehouse, gymnasium, and gatehouse. The facility has security fencing and other security features required of a new correctional facility. Construction materials are described as good to excellent quality. In addition to the housing units, the facility has areas for administration, recreation, kitchen, dining, education, segregation cells, medical, maintenance, and other uses. Construction of the facility was completed in November 2009. As of the assessment date of January 1, 2010, the improvements were 100% completed and the facility was approximately 68% occupied on January 1, 2010.

Petitioner is requesting an actual value of \$36,400,000.00 for the subject property for tax year 2010. Respondent assigned a value of \$61,914,792.00 for the subject property for tax year 2010.

Petitioner contends that the income approach is the most reliable appraisal methodology to value the subject property. Respondent has relied on the cost approach but Petitioner contends Respondent has not adequately reflected functional and external obsolescence affecting the property, and that cost does not equal value. Petitioner claims the facility has a higher number of segregated beds than regulations require and that the facility overall has a high average square footage per inmate, both resulting in functional obsolescence. Petitioner contends that the role of the owner of the property is essentially that of the lender and that agreements between the owner and the operating company relate to financing.

Respondent contends that the subject property is a new state-of-the-art facility completed during the base period and disputes Petitioner's claim that functional obsolescence applies. Respondent contends that Petitioner's claim that an experienced industry leader in building and operating private correctional facilities built significant functional obsolescence into a brand new facility is false. Petitioner's claim that this brand new facility depreciated 63% in approximately six weeks from the time construction was completed to the January 1, 2010 assessment date is not reasonable. Respondent contends that the cost approach is the most reliable appraisal approach for the subject property because it is new construction and the facility was not leased as of the date of value or during the assessment base period. Respondent contends that the income approach to value used by Petitioner is incorrect because it analyzes the income to a potential operator of the facility, not the income to the property owner. Respondent contends that the property owner and the developer/management company do not have a partnership with regard to the subject property and that any agreements that would be entered into would be between landlord and tenant.

Petitioner presented the following indicators of value:

Market:	Not presented
Income:	\$36,400,000.00
Cost:	\$36,000,000.00

Petitioner cited two previous Board of Assessment Appeals decisions, *Corrections Corporation of America v. Kit Carson County Board of Equalization, April 2002 (docket 38533)*, and *CCA Properties of America, LLC v. Huerfano County Board of Equalization, April 2009 (dockets 48067 & 50825)* as support for use and reliability of the income approach to value for correctional facilities.

Bruce Brown with the GEO Group (GEO) testified for Petitioner regarding the development history for the subject property. Cornell Companies (Cornell) was the developer of the facility and intended operator. Cornell subsequently merged with GEO, which has taken over that role. The owner of the property, Inland PPD Hudson Associates, LLC (Inland), is a REIT. Mr. Brown testified that Inland's role is essentially that of the bank, providing the financing for the facility. Therefore, any lease agreement between Inland and Cornell (now GEO) would relate to the repayment of the financing and would not represent a market lease for the property. Mr. Brown testified that a lease agreement between Inland and the operating company had not been executed as of the date of value for tax year 2010.

Mr. Brown testified that the original RFP issued by the State of Colorado was for a 700-bed women's correctional facility, but after the contract was awarded, the scope of the facility was changed to the larger gender neutral facility that was subsequently built. Before construction was completed, the State notified the developer that correctional facility needs had changed and Colorado did not plan to send inmates to the subject property. Mr. Brown testified that the average square footage per rated bed at the subject facility is larger than typical correctional facilities, that common "shared" areas are too large, and that some of the site development costs anticipated future expansion of the facility. Mr. Brown testified that after the State of Colorado pulled out, economic and functional obsolescence applied to the property. Mr. Brown also testified about the decline in demand for prisons around the country, so an economic decline was occurring before the subject facility opened in late 2009 and there was some decline before the June 30, 2008 date of value. In response to cross examination, Mr. Brown testified that Cornell (before the merger with GEO) was an experienced developer, construction manager, and operator of private correctional facilities in the country. Mr. Brown testified that Cornell executives were partly responsible for over building some of the spaces, which was a mistake, but they also anticipated future expansion of the facility. Mr. Brown estimated that the day areas in the facility are, at a minimum, 30 percent too large, though the over building is not limited to the day areas.

Stevan N. Bach, MAI of Bach Realty Advisors testified for Petitioner and presented his appraisal of the subject property. Mr. Bach considered, but did not present a conclusion of value by the market approach. The witness presented an income approach using a per diem revenue rate of \$59.26 for 1,236 rated beds based on a contract entered into with the State of Alaska for use of the facility after Colorado withdrew. The witness estimated \$50,000.00 in other income and deducted vacancy at the rate of 10% or \$2,678,456.00. The witness made deductions for operating expenses of \$45.00 per bed per day, assuming stabilized occupancy, which was equivalent to \$18,264,600.00; a 3% management fee equivalent to \$721,833.00; reserve for replacements at \$0.15 per square foot or \$45,730.00; deducted income for furniture, fixtures, and equipment of \$271,920.00; \$106,311.00 for start-up costs; and concluded to net operating income attributable to the real property of \$4,695,706.00. Using a tax loaded overall capitalization rate of 12.427851%, Mr. Bach concluded to an initial value of \$37,783,733.00. The witness then deducted \$1,395,714.00 for two years of rent loss before he estimated the property would reach stabilized occupancy and concluded to a final value by the income approach of \$36,400,000.00. Mr. Bach testified that for reasons of confidentiality, he was unable to provide actual market data he relied on to support his conclusion of vacancy, expenses, and some of the rates used in his analysis, but discussed general ranges of expenses based on confidential data and his appraisal experience.

Mr. Bach presented a cost approach analysis for the property estimating a replacement cost new of \$94,213,980.00. The witness concluded that a deduction for physical depreciation was not required, but deductions for functional and external (in this case economic) obsolescence were justified. Mr. Bach testified that functional obsolescence was due to the above average per square foot size of the facility per rated bed and because the facility has a 10% ratio of segregated beds (124 beds), though a typical ratio would be 5%. For the excess square footage, the witness calculated the cost new per square foot for a figure of \$13,152,251.00. Mr. Bach then estimated the capitalized expenses, including taxes, that would be associated with maintaining the excess square footage and concluded to a figure of \$22,566,375.00. The witness concluded to a combined deduction for

functional obsolescence of \$35,668,626.00. Mr. Bach estimated the net operating income required to support the replacement cost new of the property including the land and compared it to his projected net operating income for the property from the income approach to value, which is lower. Capitalizing that income shortfall resulted in a deduction for economic obsolescence of \$22,333,694.00. Mr. Bach also made a deduction of \$1,395,714.00 for short-term economic obsolescence due to losses that would be incurred until the property reached stabilized occupancy. The witness deducted a total depreciation figure of \$59,398,034.00 from the replacement cost new estimate resulting in a depreciated replacement cost of \$34,815,946.00. The witness estimated land value based on a list of land sales obtained from the Weld County Assessor's office and concluded to a value of \$0.50 per square foot of land area for a total land value of \$1,105,900.00. Adding the land value to the depreciated cost, the witness concluded to a value by the cost approach of \$36,000,000.00.

Mr. Bach testified that the income approach to value is more reliable than the cost approach analysis for the property and concluded to a value of \$36,400,000.00 based on the income approach.

Respondent presented the following indicators of value:

Market:	Not completed
Income:	Not completed
Cost:	\$75,000,000.00

Respondent presented James Ramsey of the Colorado Department of Corrections as its first witness. Mr. Ramsey testified that he was involved with the RFP for the subject project, including the guidelines and requirements. Mr. Ramsey testified that the State required the facility to meet American Correctional Association (ACA) standards and beyond that, the developer was otherwise responsible for the size of the structures. Mr. Ramsey testified the facility is required to have a 5% ratio of segregated beds in accordance with ACA standards and that the facility actually has 62 segregated bed cells, not 124. The segregated cells are large enough to meet the requirement to install two bunks, but ACA standards limit segregated beds to single bunk cells only. The witness testified that the average square footage per rated bed varies among correctional facilities in Colorado depending on age of the facility, the type of facility, and the space necessary to provide education, recreation, and other programs specific to each facility. Mr. Ramsey testified that facility size has increased over time and that the size of the subject facility is within a reasonable range of similar facilities for this intended population.

Respondent also presented Joe Racine, Hudson Town Administrator, as witness regarding building permits and development plan reviews. Mr. Racine testified that based on plans and a physical inspection, the facility has 63 (testimony was inconsistent about whether the facility has 62 or 63 beds) segregated bed cells.

Respondent presented Charles C. Jack, Senior Staff Appraiser for the Weld County Assessor's Office as witness regarding the valuation of the property. Mr. Jack testified that he considered the market, income, and cost approaches to value for the subject property, but the available comparable sales data was inadequate for a reliable conclusion of value by the market

approach. The witness testified that the income approach should address the potential income to the property owner, not the income to a tenant operating company's business. Because the subject property is a brand new facility that was not leased as of the assessment date, Mr. Jack concluded that there was inadequate support for the income approach analysis of the potential income to the owner. Mr. Jack concluded that because construction of the subject facility was completed during the 2010 base period, the cost approach is the most reliable indicator of value for the property. Also, the cost approach is considered the most reliable approach for special purpose properties, such as correctional facilities, where little or no market data exists.

Mr. Jack testified that he estimated the value of the land after considering the larger list of land sales provided to Petitioner's appraiser and selecting the six sales he believed to be most comparable to the subject property, including sales of sites for development of special purpose properties. The witness concluded to a land value of \$1.00 per square foot for a total value of the subject site of \$2,211,737.00. For the cost of the improvements, Mr. Jack presented a document dated December 11, 2009 showing the actual construction cost of the improvements in the amount of \$82,408,480.61. From the rounded figure of \$82,408,480.00, Mr. Jack deducted 1% or \$824,085 for physical depreciation as of the January 1, 2010 assessment date. The witness also deducted 9.94% or \$8,191,403 for economic obsolescence due to the decline in utilized beds in the 2007 and 2008 data collection period. After making the deductions for physical depreciation and economic obsolescence, and adding the land value of \$2,211,737.00, the resulting indication of value using the actual construction costs was \$75,604,729.00. Mr. Jack testified that he considered a deduction for functional obsolescence, but the property is a brand new, state-of-the-art facility designed and built by leaders in the correctional facility industry to meet ACA standards and cited other evidence that the facility has only the required 5% segregated beds, not 164 as claimed by Petitioner. Mr. Jack concluded that an adjustment for functional obsolescence was not warranted.

Mr. Jack also estimated the replacement cost new of the improvements using a state-approved cost estimating service to derive a market-adjusted replacement cost value for the subject improvements of \$80,309,700.00. The witness deducted the 9.94% economic obsolescence estimate used in the actual cost analysis and added the land value to derive a total value for the property of \$74,538,653.00. After considering both analyses, the witness concluded to a market value for the subject property of \$75,000,000.00.

Respondent assigned an actual value of \$61,914,792.00 to the subject property for tax year 2010.

Respondent presented sufficient probative evidence and testimony to show that the value presented for the subject property for tax year 2010 is reliable.

With regard to the two BAA cases cited by Petitioner in which the income approach was given most weight, the Board finds that the subject properties in both cases were ten years old or more and had established operating histories. Also, the ages of the facilities would have required different considerations relative to incurable physical depreciation in addition to any other forms of depreciation that may have applied. The Board concludes that although the BAA determined the income approach to be the most reliable methodology presented in those cases, it is not to be

construed that the income approach is the most reliable in the valuation of all correctional facilities. The Board finds that all three approaches to value may be applicable to the valuation of the subject property. However, one or more of the approaches may be eliminated or be given less weight based on the quality of the data available.

Petitioner's appraiser relied on the income approach to value the property based on a pro forma analysis of net income to the operation. The appraiser based the per diem per bed revenue estimate on an actual contract rate with additional support provided regarding other per diem rates in Colorado. The Board finds that the vacancy rate, other income, expense estimates, and some of the rates used in the income analysis were not supported with evidence of actual comparable data derived from the market. The appraiser discussed general ranges he believed to be applicable, but testified that for reasons of confidentiality, he was unable to provide actual revenue and expense comparables for those components of the income analysis. The appraiser also estimated two years of rent loss before the property could reach stabilized occupancy, without providing any significant evidence of absorption history at other facilities to support the two year absorption period. Petitioner's appraiser did not analyze the income potential of the property to the current owner under the planned scenario that Petitioner would lease the facility to the operating company. In considering the validity of that approach, the Board has relied on the Development Agreement presented as evidence which states: *"Nothing contained in this Agreement shall constitute or be construed to be or create a partnership or joint venture between Owner or its successors or assigns, and Developer, or its successors or assigns."* The Agreement further states: *"It is specifically agreed that this Agreement shall not constitute a covenant running with the land, and Developer shall have no lien rights or other interest in the Project, or any part thereof, under any of the provisions hereof."* Although Petitioner contends the owner has simply acted in the capacity of a bank providing financing, the Board concludes that the "lender" in this case, in fact, owns the property and the "borrower" will have the role of a tenant. Therefore, it would be valid to also consider the pro forma revenue the owner could derive from leasing the facility as the potential income to the real estate.

Though the property was new construction on the assessment date, the appraiser presented a cost approach analysis only as general support for the income approach. The appraiser did not present land sales or an analysis to demonstrate the conclusion of value for the land used. The appraiser used deductions totaling 63% of the appraiser's estimated replacement cost new of the improvements for functional and economic obsolescence.

The Board has relied on the testimony provided that the State of Colorado did not require the subject facility be constructed to a greater size than required by ACA standards or that the number of segregated beds exceed the 5% ACA standard. The Board has also relied on testimony by Respondent's witnesses that the facility has 62 or 63 segregated cells but not 124. The Board found that evidence showed that although the rate of growth in the adult inmate population in Colorado was slowing, the population was still, in fact, increasing as of the date of value. Based on testimony and evidence provided by both parties, the Board concludes that the developer was a well informed and experienced developer and operator of private correctional facilities and the design and size of the subject facility was based on an informed business decision. Therefore, the Board is not convinced by Petitioner's claim that the developer simply made a mistake by building various areas within the facility too large, thus creating significant functional obsolescence. The Board has relied on

testimony given by Mr. Ramsey that the average size per rated bed at the subject is within a reasonable range of similar facilities for this intended population with spaces needed for the services provided. Therefore, the Board concludes that Petitioner's functional obsolescence argument is not supported by the evidence.

The Board concludes that the minimal support provided in the form of data derived from the market for the conclusions regarding some of the revenue, the expenses, and some rates used in Petitioner's income approach analysis is inadequate to prove that the value of the property as if stabilized should be approximately 61% lower than the appraiser's estimated replacement cost new for the improvements. By extension, the Board concludes there is inadequate support for the economic obsolescence deduction used in Petitioner's cost approach because it is based on the net income analysis. The Board has relied on the testimony of Petitioner's witness, Mr. Brown, and Respondent's witness, Mr. Ramsey, that Petitioner is allowed to accept inmates from other states with the approval of the Colorado Department of Corrections and that on the assessment date, the facility was 68% occupied by inmates from Alaska. The Board finds that evidence showed that although the rate of growth in the adult inmate population in Colorado was slowing, the population was still increasing as of the date of value. The Board finds that Petitioner's witness testimony about the decline in the private correctional facility market in the country and in Colorado conflicts with the testimony that during the base period Petitioner discussed plans for future expansion of the subject facility. The Board concludes that reliable support for the large deduction for economic obsolescence used by Petitioner was not provided.

Respondent has relied on the cost approach to value this facility and included actual construction costs in the analysis. Respondent concluded to a value for the property that is lower than the actual cost of construction of this new facility plus the land value.

Based on the quality of the data provided by both parties and the new construction of the subject facility, the Board concludes that the cost approach produces a more reliable indication of value for the subject property.

ORDER:

The petition is denied.

APPEAL:

If the decision of the Board is against Petitioner, Petitioner may petition the Court of Appeals for judicial review according to the Colorado appellate rules and the provisions of Section 24-4-106(11), C.R.S. (commenced by the filing of a notice of appeal with the Court of Appeals within forty-five days after the date of the service of the final order entered).

If the decision of the Board is against Respondent, Respondent, upon the recommendation of the Board that it either is a matter of statewide concern or has resulted in a significant decrease in the

total valuation of the respondent county, may petition the Court of Appeals for judicial review according to the Colorado appellate rules and the provisions of Section 24-4-106(11), C.R.S. (commenced by the filing of a notice of appeal with the Court of Appeals within forty-five days after the date of the service of the final order entered).

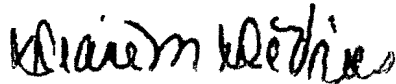
In addition, if the decision of the Board is against Respondent, Respondent may petition the Court of Appeals for judicial review of alleged procedural errors or errors of law within thirty days of such decision when Respondent alleges procedural errors or errors of law by the Board.

If the Board does not recommend its decision to be a matter of statewide concern or to have resulted in a significant decrease in the total valuation of the respondent county, Respondent may petition the Court of Appeals for judicial review of such questions within thirty days of such decision.

Section 39-8-108(2), C.R.S.

DATED and MAILED this 23rd day of April, 2012.

BOARD OF ASSESSMENT APPEALS

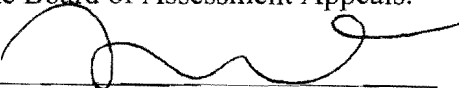


Diane M. DeVries



Louesa Maricle

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



Milla Crichton