

<p>BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203</p> <hr/> <p>Petitioner:</p> <p>CCA PROPERTIES OF AMERICA, LLC,</p> <p>v.</p> <p>Respondent:</p> <p>HUERFANO COUNTY BOARD OF EQUALIZATION.</p>	<p>Docket No.: 62275</p>
<p>ORDER</p>	

THIS MATTER was heard by the Board of Assessment Appeals on February 19, 2014, Diane M. DeVries and Gregg Near presiding. Petitioner was represented by Gary M. Kramer, Esq. Respondent was represented by Deirdre Santoscoy, Esq. Petitioner is protesting the 2013 actual value of the subject property.

Subject property is described as follows:

**304 Ray Sandoval Street
Walsenburg, CO 81089
Huerfano County Schedule No. 44541-R**

The subject is a correctional facility known as the Huerfano County Correctional Center. Completed in 1997/1998, the prison contains 799 beds in several buildings totaling 205,949 square feet. Buildings include inmate housing areas, administrative offices, support service (medical, library, intake area, etc.), gymnasium and a greenhouse. Outside improvements include recreational areas, security fencing, lighting, cameras and paved parking. The facilities are currently vacant but are being maintained on a regular basis.

Petitioner presented the following indicators of value:

Market:	\$9,500,000 to \$11,900,000
Cost:	\$10,700,000
Income:	\$10,600,000

Petitioner is requesting an actual value of \$10,600,000 for the subject property for tax year 2014.

Petitioner’s witness Stevan N. Bach, a Certified General Appraiser, presented a market approach consisting of three comparable sales from various sections of the United States. The sales ranged in sale price from \$21,069,000 to \$72,770,260 and contained from 495 to 1,498 beds. The sale prices per bed ranged from \$42,564 to \$48,578 before adjustment. After adjustments were made, the sales ranged from \$22,400 to \$25,550 per bed. After deducting for rent loss, F.F. & E replacement, and costs associated with vacancy, Mr. Bach concluded to a value range of \$9,500,000 to \$11,900,000.

The comparable sales were all from locations considered superior. Two of the sales had contracts in place to house inmates. Downward adjustment of approximately 30% was applied to all sales for personal property and intangibles including business value. Mr. Bach noted the reliability of this approach was limited due to large adjustments and insufficient knowledge of the complexities of each transaction.

Mr. Bach presented a cost approach to derive a market-adjusted cost value for the subject property of \$10,700,000.

Using costs from the Marshall Valuation Service for an average to good quality Class C facility and reviewing actual costs for two recent prison projects, Mr. Bach concluded to a cost new for the buildings of \$200.00 per square foot, or \$41,189,800. Site improvements totaling \$1,200,000 were added for an estimated \$42,389,800 in hard costs. Additional adjustments of 15% for Entrepreneurial Profit and other soft costs were applied to determine replacement cost new of \$48,748,270. Physical depreciation was estimated at 30% of replacement cost new for the buildings and 40% of replacement cost new for the site improvements. Based upon the shortfall from the net income the facility can obtain compared to the current market returns required for the investment in land and building, a downward adjustment of \$16,036,687 was applied for External Obsolescence. Land value was estimated to be \$1,500 per acre for 43.4 acres attributed to the correctional facility with 38.26 acres valued as fallow agricultural land for a total of \$103,500. Addition of the land value results in a replacement cost new less depreciation of \$18,052,607. An additional downward adjustment was made to the value estimate of \$7,377,216 to represent costs for F.F.& E, rent loss until full occupancy and other start-up expenses.

The following summarizes Mr. Bach’s calculations:

<i>Total Replacement Cost New</i>	<i>\$48,748,270</i>
Physical Depreciation	(\$14,762,476)
External Obsolescence	(\$16,036,687)
Depreciated Building Cost:	\$17,949,107
81.66 Acres	\$103,500
Replacement Cost New Less Depreciation	\$18,052,607
Start-up cost	(\$7,377,216)

Value by the Cost Approach	\$10,700,000
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Petitioner’s witness presented an income approach to derive a value of \$10,600,000 for the subject property. Mr. Bach discussed contract rates in Colorado including a cancelled Arizona contract and a soon to be terminated contract with Alaska and determined a market per diem of \$60.00. Revenue from commissary sales, telephone and other sources was added resulting in total gross revenue of \$17,142,552. Mr. Bach subtracted a 15% vacancy allowance to determine collected revenues. Expenses of \$49.00 per occupied bed per day and a 3% management fee were deducted as well as reserves to reach a preliminary net income estimate of \$2,654,032. Additional expenses for F.F.& E and start-up costs reduced the annual net income estimate to \$2,364,108. A weighted capitalization rate of 10.7522%, rounded to 11%, was then estimated by use of the band of investment. The capitalization rate was then increased by 2.15566% to recognize the property tax rate applicable to the subject. The net income estimate was then capitalized by the developed rate to determine a value estimate of \$17,970,273. Mr. Bach then reduced this figure for two years of anticipated rent loss as the facility was vacant on the value date. Other reductions were applied for replacement of F.F. & E, maintenance and taxes over the two year period to reach full occupancy. After these additional deductions, Mr. Bach concluded to a value by the income approach of \$10,600,000.

Mr. Bach considered all three approaches in his final reconciliation and gave greatest weight to the indication derived by the income approach to conclude to a final value of \$10,600,000.

Petitioner’s witness Andrea Evans, Senior Director with CCA, testified regarding her position with the organization. Ms. Evans testified her job was to maintain contracts and find tenants for CCA properties. Ms. Evans described the retraction in the prison population nationwide overall; attempts to re-negotiate the Huerfano facility contract at a lower per diem and the federal regulations regarding wage scales. Colorado’s higher wages make bids for federal prisoners less competitive.

Petitioner’s witness Michael T. Henry, a property tax consultant, testified regarding his experience as a representative for CCA. He described CCA and the GEO group as the primary operators in the national correctional facility business with up to three smaller companies providing similar services. Prior to 2008 he indicated it was unheard of for a contract to be terminated. As contract terminations increased with the declining market, more than 27,000 new beds came on the market and an oversupply resulted. Mr. Henry stated the current industry occupancy is 80% and typical management cost is in the range of 5%.

Respondent presented the following indicators of value:

Market:	\$30,100,000
Cost:	\$38,000,000
Income:	\$27,150,000

Respondent’s appraiser Ivor J. Hill, a Certified General Appraiser, presented a market approach consisting of one comparable sale occurring in January 2012 for \$72,700,000. The resulting indications from that sale were \$40,434 per bed and \$255.70 per square foot. Mr. Hill

concluded to a unit value of \$40,000 per bed and an indicated value of \$30,000,000. To this figure Mr. Hill added \$129,486 for excess land and concluded to a value of \$30,100,000 by the market approach.

Mr. Hill also used the Marshall Valuation Service, to derive a market-adjusted cost value for the subject property of \$38,000,000.

Mr. Hill presented three land sales in the area that occurred from May 2005 to May 2006, outside the extended base period. After adjustments to the sales Mr. Hill concluded to a value of \$2,750 per acre for 20 acres deemed necessary for the prison operation. The same sales were adjusted to a concluded value of \$2,100 per acre for the remaining 61.66 acres defined as excess land. Mr. Hill applied average quality Class C costs from the Marshall Valuation Service to the buildings and included indirect costs of 3%. Site development costs of \$2,980,843 were added for a total cost new of \$40,719,890. No costs were added for entrepreneurial profit. Physical depreciation of 8% was applied to the buildings based on the cost service depreciation tables and a 35% deduction was applied to the site improvements. Total land value of \$184,486 was added to the depreciated improvement value for a final value of \$38,000,000.

Petitioner's witness used the income approach to derive a value of \$27,150,000 for the subject property. Mr. Hill discussed contract rates in Colorado and a recent contract with the State of Arizona and determined a per diem of \$52.69 per inmate per day. Additional revenue from commissary sales, telephone and other sources of 1.5% was added and total gross revenues were estimated at \$14,719,504. Mr. Hill subtracted a 4% vacancy allowance to determine collected revenues. Additional expenses including a 1% management fee, operational expenses of \$41.87 per occupied bed per day, insurance and reserves were deducted to reach a preliminary net income estimate of \$2,838,814. A capitalization rate of 8.5% was estimated by use of the band of investment which was then increased by 2.16% to recognize the property tax rate applicable to the subject. Mr. Hill concluded to a capitalization rate of 10.5%. The net income estimate was then capitalized by the developed rate to determine a value estimate of \$27,036,324. Addition of the excess land component resulted in a value opinion of \$27,150,000 after rounding.

Mr. Hill considered all three approaches in his final reconciliation and gave greatest weight to the income approach to conclude to a final value of \$27,150,000.

Respondent's witness David Bobian, Clerk II in the Huerfano County Assessor's Office, testified regarding research he conducted for Respondent's Exhibit M, an estimate of annual inmate costs in Colorado facilities.

Petitioner contends the property, which has been vacant since April 2010, was valued inappropriately. Petitioner also protests the actions of Huerfano County in disregarding a stipulated value of \$15,000,000 agreed upon on April 12, 2012. Petitioner disagrees with Respondent's income valuation as it assumes the property to be up and operating as of the value date.

Respondent contends the facility is ready for occupancy and, given the overcrowding in the prison system overall, there are multiple opportunities for the owner to obtain contracts to house

inmates. Although the property is currently vacant, Respondent's position is that the expected 2-year start-up to reach full occupancy should be complete by the value date. Respondent also questions Petitioner's deductions for work force training as an inappropriate adjustment for business expense. Respondent also claims Petitioner has incorrectly reduced the value estimate by replacing F.F.& E when some items are currently in place.

The Board agrees that the income approach is the most appropriate valuation method in this instance. The Board also found it supportive that both parties determined net operating income, prior to any reduction for start-up expenses or reserves that were extremely similar; \$2,705,519 for Petitioner and \$2,838,814 for Respondent.

The parties moved in two different directions after that point. Petitioner's appraiser adopted an investor return rate of 8% and added a 2.86% recapture rate to conclude to an overall rate of 11% (rounded). Respondent's appraiser adopted a 6.75% mortgage interest rate for 75% of the property value with a 10% return rate for the equity investor to conclude to an overall rate of 8.5%. Both parties adjusted their adopted overall rates upward to reflect the tax load to reach final rates of 13.15566% for Petitioner and 10.5% for Respondent.

The Board finds the primary reason for the differences in the two overall rates results from Petitioner's position the facility is vacant and Respondent's position the property could be fully operational with diligent effort on the part of Petitioner.

Petitioner presented sufficient probative evidence and testimony to prove that the tax year 2013 valuation of the subject property was incorrect.

The Board has already noted the different direction the parties took in regard to their concluded overall rates but that does not begin to address the significant disparity in the final value conclusions.

Respondent's appraiser chose to adopt a Hypothetical Condition (Ex. A, p. 7) that the existing, vacant facility was in operation at occupancy levels typical of other, similar facilities as of the valuation date.

The Uniform Standards of Professional Appraisal Practice, USPAP, provides the following definition of a Hypothetical Condition:

HYPOTHETICAL CONDITION: a condition, directly related to a specific assignment, which is contrary to what is known by the appraiser to exist on the effective date of the assignment results, but is used for the purpose of analysis.

Comment: Hypothetical conditions are contrary to known facts about physical, legal, or economic characteristics of the subject property; or about conditions external to the property, such as market conditions or trends; or about the integrity of data used in an analysis.

Contrary to known fact regarding the subject's occupancy, Respondent's appraiser capitalized the income stream at a rate that appears reasonable for a fully operational facility, leased at market rate and capable of being financed by any number of willing lenders. Respondent's analysis in no way corresponds with reality and serves no purpose for this hearing.

The Board finds Petitioner's appraiser correctly reported the property to be vacant with the exception of maintenance staff. Under that condition, the appraiser approached the net income stream subject to typical market conditions such as; lease-up; provision of F.F.& E; staffing; etc.

The value opinion derived by Petitioner's appraiser is also not without question. Particularly troubling to the Board was the process summarized in Ex. 1, pages 51-52. After concluding to a stabilized market value of \$18,000,000, Petitioner's appraiser continues in this single sentence: "There is need for \$7,347,489 of various deductions and the "as is" market value is \$10,600,000." Reduction of the value opinion by 41% in a single statement is insufficient justification.

The Board agrees with and adopts Petitioner's stabilized market value of \$18,000,000 by use of the income approach. The following additional adjustments are applied:

Rent Loss for 2 years	\$2,364,108
F.F.& E Replacement:	\$376,000
Facility Maintenance Costs:	\$720,000
Real Estate Taxes	\$228,500
TOTAL	\$3,688,608

The Board considers Petitioner's adjustments for the 2-year lease up period to be excessive. As an example, Petitioner's appraiser adjusted for two complete years of rent loss when realistically by the end of the first year the facility should be half full. The other adjustments above are related to this same contention.

Reduction of \$3,688,608 from the stabilized market value of \$18,000,000 indicates an "as is" value of \$14,311,392.

The Board concludes that the 2013 actual value of the subject property should be reduced to \$14,311,392.

ORDER:

Respondent is ordered to reduce the 2013 actual value of the subject property to \$14,311,392.

The Huerfano County Assessor is directed to change his/her records accordingly.

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-nine 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-nine 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 17th day of March, 2014.



BOARD OF ASSESSMENT APPEALS

Diane M. DeVries

Gregg Near

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

Milla Lishchuk