BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203 Petitioner: **HT 6979 S HOLLY CIRCLE, LLC,** v. Respondent: **ARAPAHOE COUNTY BOARD OF EQUALIZATION.**	**Docket No.: 66692**

ORDER

THIS MATTER was heard by the Board of Assessment Appeals on December 1, 2016, Diane M. DeVries and Gregg Near presiding. Petitioner was represented by Eric Steiner, Esq. Respondent was represented by Benjamin Swartzendruber, Esq. Petitioner is protesting the 2015 actual value of the subject property.

The parties agreed at the beginning of the hearing to the admission of Petitioner's Exhibits 1-15; to Respondent's Exhibits A and B and to the qualifications of Respondent's expert witness.

Subject property is described as follows:

6979 S Holly Circle
Centennial, CO 80012
Arapahoe County Parcel No. 2075-29-2-12-004

The subject is a free-standing Class B medical office building containing a net rentable area of 26,464 square feet built in 1983 on a 1.6 acre site. The building includes a 4,421 square foot partial walkout basement of which 3,199 is finished as a health club. The structure is designed for multi-tenant occupancy.

Petitioner is requesting an actual value of $1,750,000 for the subject property for tax year 2015. Respondent assigned a value of $2,219,000 for the subject property for tax year 2015 and is submitting a site-specific appraisal for $2,795,000 in support.

Petitioner presented the following indicators of value:

Market:	$1,678,408
Cost:	Not applied
Income:	$1,976,841

Petitioner's witness, Mr. David Hesslein, testified regarding his purchase of the subject property in 2011. Mr. Hesslein stated the property was under receivership and he paid $1,850,000 for the note. A price of $2,209,000 was recorded by the county but the witness indicated his total cash outlay was $1,850,000. Mr. Hesslein related he was not allowed to visit the building prior to purchase and he relied upon documents provided by the seller and a site visit by a broker. Although he knew there were maintenance issues with the property, the witness indicated he was not aware of issues with the HVAC (heating/ventilation) and the condition of the parking lot. Also affecting the property value were leases nearing expiration and anticipated expenses for tenant improvements. Since the 2011 purchase, improvements have been made to the common areas, landscaping and repairs to the HVAC. Occupancy in the building was approximately 65% to 67% at the time of purchase and it is currently 24% with the first new tenant signed in 2014. Mr. Hesslein described the subject as an "off campus" medical building, one that does not offer close proximity to a hospital and would be attractive to specialists. The subject, without hospital proximity, is limited to other, "stand alone" users such as dentists. The witness reported rentals that were once in the $25.00 per square foot range are now being renewed at rates from $20.00 to $21.00/sf. Mr. Hesslein also stated that hail damage in 2014 required a full roof replacement for which insurance contributed only $10,000 and that replacement of the parking lot, to be done in 1/3 increments, began in 2015 with the second phase to be completed in 2017.

Petitioner presented Ms. Dora Fessler, property manager for Griffis/Blessing Inc. since 2014. Ms. Fessler testified in regard to Petitioner's Exhibits 4 and 5. Exhibit 4, titled as "Schedule of Deferred Maintenance", identified costs for replacement of the HVAC, the recent roof replacement in 2015, the schedule for parking lot replacement and the cost for tenant improvements for $3,814 square feet of office space. The deferred maintenance costs illustrated in the Exhibit are $554,815. Ms. Fessler stated the HVAC has been an ongoing problem with $45,000 spent for repairs on the system in 2013. The witness also reported that new tenants receive an improvement allowance of $50.00/sf as illustrated by Exhibit 4, pages 8-11. Exhibit 5, pages 2 through 21, shows the cash flow statements and annual rent rolls in 2013 and 2014. (Exhibit 5, page 12 shows the new tenant to have signed a 10-year lease.)

Petitioner presented the final witness, Mr. Roger Bruhn, as an agent for the property owner. The witness stated he relied upon the information provided by CoStar, Arapahoe County records and to reading *The Appraisal of Real Estate* published by the Appraisal Institute.

Petitioner's witness presented sales of six office/medical buildings ranging in sale price from $800,000 to $2,750,000 ($32.01 to $113.17 per square foot of building area) and in size from 18,492 to 31,307 square feet. After adjustments were made, the sales ranged from $50.18 to $76.96 per square foot.

Mr. Bruhn summarized the comparable sales and applied a time adjustment to all the transactions except Sale 4 which closed in June 2014. On the following page, the witness provided an adjustment grid where the time adjusted sale prices were then further adjusted for features such as location, construction quality, condition and occupancy. After averaging the adjusted indications, the witness concluded to a unit value of $63.42 per square foot. Mr. Bruhn then applied this unit value to the subject's area of 26,464 square feet to conclude to an indicated value of $1,678,408. The witness testified that he accepted the information presented by CoStar without confirmation from any of the parties involved.

Mr. Bruhn presented an income approach to derive a value of $1,976,841 for the subject property (Exhibit 15). Using information obtained from CoStar for several buildings in the southeast metro area, the witness concluded to a current rental rate of $20.00 per square foot and a vacancy rate of 15%. After adding $20,734 of additional income, Mr. Bruhn concluded to an Effective Gross Income (EGI) of $502,612. After deduction of operating expenses, the witness determined a Net Operating Income (NOI) of $208,862. To establish a capitalization rate, Mr. Bruhn cited 8 transactions reported by CoStar with sale dates from March 20, 2013 to June 18, 2014. Taking the average of the sales at 8.21%, the witness adopted 8.25% as appropriate. Capitalization of the NOI at a rate of 8.25% produced a value before adjustment for deferred maintenance of $2,531,656. Subtracting $554,815 for deferred maintenance produced an adjusted indicated value of $1,976,841. Mr. Bruhn reconciled the two approaches and concluded a final value of $1,750,000.

Respondent presented the following indicators of value:

Market:	$2,780,000
Cost:	Not applied
Income:	$2,795,000

Respondent's witness, Mr. Jeff Hamilton, a Certified General Appraiser, presented a market approach (sales comparison approach) containing four comparable sales ranging in sale price from $1,731,050 to $3,900,000 ($68.29 to $113.17 per square foot of building area) and in size from 24,300 to 42,052 square feet. After adjustments were made, the sales ranged from $102.02 to $107.51 per square foot.

Mr. Hamilton adjusted the sales for features such as conditions of sale, location, size, age, parking and condition. After consideration of the adjustments and the similarity of the sales to the subject, the witness concluded to a unit value of $105.00 per square foot. Mr. Hamilton then applied this unit value to the subject's rentable area of 26,464 square feet to conclude to an indicated value of $2,778,720 ($2,780,000 rounded).

Respondent's witness presented an income approach to derive a value of $2,795,000 for the subject property. Mr. Hamilton reviewed the subject's rent roll and determined a weighted average for the in-place leases for typically sized tenants to be $20.97 per square foot. Comparing this conclusion with the average of the three most recent leases in the building of $20.42/sf, the witness concluded to a stabilized rate of $20.50/sf.

In addition, the witness reported and analyzed five different rental comparables either leased or offered for lease during the valuation period. The adjusted leases suggested a range from $20.00 to $21.00 per square foot. The witness adopted a rate of $20.50/sf as appropriate for the subject.

Occupancy in the subject building was 74% as of the valuation date. Published data for medical office buildings in the subject's market area indicated an overall office vacancy of 11.4%. Noting that medical office buildings typically reflect vacancy rates 3% to 4% lower than general office, the witness adopted a stabilized vacancy rate of 10%.

Other income accrues to the property from basement space rented to a health facility and pass through income calculated as $56,990. EGI for the building was calculated to be $545,251.

The witness analyzed the building expenses provided for 2013 and 2014 and, after separating them into typical categories, determined a stabilized expense of $7.32/sf. Comparison with two other buildings and with the information derived from Sale 1 indicated expense rates of $5.37, $7.30 and $7.50 respectively. After analysis of the expenses of the subject and the other properties in each typical category, Mr. Hamilton concluded to an expense estimate of $7.80/sf including $0.50/sf for reserves.

To determine the capitalization rate, the witness considered rates available through alternative investments, published rates and rates derived from local transactions. Rates from the above sources narrowed to a range of approximately 7% to 8% and Mr. Hamilton adopted 7.5%. The market capitalization rate was then increased by loading the Effective Tax Rate of 3.08% for a concluded cap rate of 10.58%. The witness then subtracted the expenses from EGI to determine an NOI of $338,727. Application of the concluded cap rate to the NOI resulted in a value indication of $3,201,577, rounded to $3,200,000. Mr. Hamilton then deducted $405,000 from the above to represent the costs incurred to raise the subject from its present 74% occupancy to a stabilized vacancy rate of 10%. The final conclusion of the income approach, after the above reduction, was $2,795,000. In his reconciliation the witness concluded to a final value of $2,795,000.

Respondent assigned an actual value of $2,219,000 to the subject property for tax year 2015 supported by a site specific appraisal report concluding to a value of $2,795,000.

Petitioner contends the subject property has significant deferred maintenance, low occupancy, difficulty in attracting new tenants and suffers from an "off campus" location. Because the building is not in proximity to a hospital, tenants are limited to stand alone uses such as a dentist. Any potential buyer would discount an offer to purchase after recognizing the necessity to correct these deficiencies. As an alternative, the buyer might adjust the expected capitalization rate for this factor. Petitioner asserts that Respondent has adopted income estimates, occupancy rates and capitalization rates that are unreasonably optimistic resulting in a gross overvaluation.

Respondent contends Petitioner has failed to meet its burden of proof. Petitioner's agent developed an artificially low value opinion by overstating expenses combined with an incorrect capitalization rate. Respondent takes the position Petitioner's agent erred in his analysis of the building expenses, has failed to analyze or confirm comparable sales and leases from the market and, in the case of the market approach, used inappropriate comparable sales from distant locations. Respondent argues Petitioner's agent has relied only upon the income information provided by the client and has failed to provide verified support from comparable properties for either his income or expense estimates.

The Board finds little merit in the value opinion provided by Petitioner. Petitioner's agent testified to no education in appraisal practice other than his reading of what was referenced, incorrectly, as the "handbook" of the Appraisal Institute. In presenting his opinion of actual value, Petitioner's agent stated multiple times that he did not confirm the data considered with any party to the transaction(s). The agent's comment that a Real Estate Owned (REO) transaction was equivalent to market value simply because the lender-owned property was exposed to the market contradicts the definition of market value and causes the Board to question the reliability of the witness's appraisal. The Board also rejects Petitioner's conclusion within the income approach finding that Petitioner incorrectly applied deferred maintenance and reserves for replacement. Both parties agreed that deferred maintenance was significant in the determination of actual value and the Board found Respondent's approach reasonable. The Board was swayed by Respondent's exhibits and testimony finding the conclusions to have been well supported and the pertinent valuation questions correctly considered.

Overall the Board has no confidence in the analysis presented by Petitioner's agent. Petitioner presented insufficient probative evidence and testimony to prove that the subject property was incorrectly valued for tax year 2015.

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-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 4th day of January, 2017.

BOARD OF ASSESSMENT APPEALS

Gregg Near

Diane M. DeVries

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

Milla Lishchuk

STATE OF COLORADO SEAL BOARD OF ASSESSMENT APPEALS

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