12-1179
TAX TYPE: PROPERTY TAX-LOCALLY ASSESSED
TAX YEAR: 2011
DATE SIGNED: 6-10-2013
COMISSIONERS: D. DIXON, M. CRAGUN, R. PERO
EXCUSED: B. JOHNSON

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. BOARD OF EQUALIZATION OF SALT LAKE COUNTY, STATE OF UTAH, Respondent.	**INITIAL HEARING ORDER** Appeal No. 12-1179 Parcel No. ##### Tax Type: Property Tax / Locally Assessed Tax Year: 2011 Judge: Chapman

This Order may contain confidential "commercial information" within the meaning of Utah Code Sec. 59-1-404, and is subject to disclosure restrictions as set out in that section and regulation pursuant to Utah Admin. Rule R861-1A-37. Subsection 6 of that rule, pursuant to Sec. 59-1-404(4)(b)(iii)(B), prohibits the parties from disclosing commercial information obtained from the opposing party to nonparties, outside of the hearing process.
Pursuant to Utah Admin. Rule R861-1A-37(7), the Tax Commission may publish this decision, in its entirety, unless the property taxpayer responds in writing to the Commission, within 30 days of this notice, specifying the commercial information that the taxpayer wants protected. The taxpayer must mail the response to the address listed near the end of this decision.

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, from TAXPAYER
REPRESENTATIVE-2 FOR TAXPAYER, from TAXPAYER
For Respondent: RESPONDENT, from the Salt Lake County Assessor's Office

STATEMENT OF THE CASE

TAXPAYER ("Petitioner" or "taxpayer") brings this appeal from the decision of the Salt Lake County Board of Equalization ("County BOE"). This matter came before the Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on March 4, 2013.

At issue is the fair market value of an office building as of the January 1, 2011 lien date. The subject property is located at ADDRESS in CITY, Utah. The County BOE sustained the $$$$$ value at which the subject property was assessed for the 2011 tax year. The taxpayer asks the Commission to reduce the subject's value to $$$$$. The County asks the Commission to reduce the subject's value to $$$$$.

APPLICABLE LAW

Utah Code Ann. §59-2-103(1) provides that "[a]ll tangible taxable property shall be assessed and taxed at a uniform and equal rate on the basis of its fair market value, as valued on January 1, unless otherwise provided by law."

UCA §59-2-102(12) defines "fair market value" to mean "the amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts."

UCA §59-2-1006(1) provides that "[a]ny person dissatisfied with the decision of the county board of equalization concerning the assessment and equalization of any property, or the determination of any exemption in which the person has an interest, may appeal that decision to the commission . . . ."

For a party who is requesting a value that is different from that determined by the County BOE to prevail, that party must: 1) demonstrate that the value established by the County BOE contains error; and 2) provide the Commission with a sound evidentiary basis for reducing or increasing the valuation to the amount proposed by the party. *Nelson v. Bd. of Equalization of Salt Lake County*, 943 P.2d 1354 (Utah 1997); *Utah Power & Light Co. v. Utah State Tax Comm'n*, 590 P.2d 332, (Utah 1979); *Beaver County v. Utah State Tax Comm'n*, 916 P.2d 344 (Utah 1996); and *Utah Railway Co. v. Utah State Tax Comm'n*, 5 P.3d 652 (Utah 2000).

DISCUSSION

The subject property is comprised of ##### acres and a two-story office building that was built in the mid-1980's. The subject has ##### square feet of rentable space (##### square feet on the main floor and ##### square feet on the second floor). The taxpayer stated that the subject property is a Class C office building, which the County did not refute.

The subject property has been experiencing a large amount of vacancy since at least 2008, when the taxpayer's representatives began managing the property. On January 1, 2011, the subject property was %%%%% vacant. As of the date of the hearing, the subject is %%%%% vacant even though the taxpayer is offering six months of free rent and paying for most tenant improvements (most of the empty offices need carpeting and paint).

The County has prepared an income approach in which it first estimated the subject's "stabilized value" with a %%%%% stabilized vacancy rate. The County then estimated the short-term losses associated with the subject's excess vacancy (based on a three year lease-up period). The County deducted the short-term losses from the stabilized value to arrive at its estimated fair market value of $$$$$. The County asks the Commission to reduce the subject's value to $$$$$, which was derived as follows:

#####	Rentable Sq. Ft. of Main Floor
x $$$$$	Market Rent per Sq. Ft. of Main Floor
$$$$$	Potential Gross Income ("PGI") of Main Floor
#####	Rentable Sq. Ft. of 2nd Floor
x $$$$$	Market Rent per Sq. Ft. of 2nd Floor
$$$$$	PGI of 2nd Floor
$$$$$	PGI (Total of $$$$$ for Main Floor and $$$$$ for 2nd Floor)
- $$$$$	Vacancy & Collection Losses (%%%%% of PGI)
$$$$$	Effective Gross Income ("EGI")
- $$$$$	Reserves Expense (%%%%% of EGI)
- $$$$$	Operating Expenses (%%%%% of main floor EGI and %%%%% of 2nd floor EGI)
$$$$$	Net Operating Income ("NOI")
- %%%%	Capitalization Rate (%%%% rate + %%%% 2011 property tax rate)
$$$$$	Stabilized Value Derived with this Income Approach (rounded)

-$$$$$	Minus Short-term Losses Associated with Excess Vacancy - Rent
-$$$$$	Minus Short-term Losses Associated with Excess Vacancy – Commissions
- $$	No Short-term Losses for Tenant Improvements
$$$$$	Final Estimated Fair Market Value (rounded)

The taxpayer agrees with the County's income approach with four exceptions: 1) the taxpayer contends that the subject's total and main floor square footages are higher than the County's square footages. The taxpayer produced a rent roll that shows that the subject's total square footage is ##### square feet (##### square feet on the main floor and ##### square feet on the 2nd floor); 2) the taxpayer contends that the County's operating expenses are lower than its actual operating expenses; 3) the taxpayer contends that the capitalization rate (prior to adding the property tax rate) should be %%%%% instead of the %%%%% rate the County used; and 4) the taxpayer contends that the County's short-term rent losses should have also included tenant improvements (at $$$$$ per square foot) instead the $$$$$ amount the County used. The taxpayer states that once these four changes are made, the County's income approach produces a value of $$$$$.[1] For these reasons, the taxpayer asks the Commission to reduce the subject's 2011 value to $$$$$.

The County agrees with the square footage changes shown by the taxpayer's rent roll. However, it disagrees with the other three requested changes. These three issues will be addressed separately.

Operating Expenses. The taxpayer asks the Commission to adjust the County's income approach to reflect operating expenses of $$$$$ (which is the taxpayer's actual expenses for the 2011 tax year once property taxes are deducted). The County contends that the taxpayer's 2011 expenses should not be used because they were not known on the lien date. The taxpayer also proffered their 2010 actual expenses, which amounted to $$$$$ (once property taxes are deducted).

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1 The taxpayer changed its income approach at the hearing once it became clear that it was deducting property taxes both as an expense and in the capitalization rate. The taxpayer did not submit a document showing how the $$$$$ estimate was calculated once it made changes at the hearing.

The expenses used by the two parties are only %%%%% apart. However, the taxpayer's operating expenses are more convincing. First, the taxpayer's actual expenses for 2010 and 2011 are almost identical and may be low because the subject property was experiencing excess vacancy. The taxpayer pays all expenses. Its tenants do not pay expenses. It is likely that the taxpayer's actual operating expenses for 2010 and 2011 are lower than they would have been had the subject property been fully leased because the subject's current vacant spaces would have had tenants using utilities such as electricity. Second, the County's estimate of operating expenses is based on $$$$$ of expenses per square foot for the main floor and $$$$$ of expenses per square foot for the 2nd floor. The taxpayer explained that its expenses per square foot are the same for the main and 2nd floors. For these reasons, the taxpayer's proposed operating expenses of $$$$$ appears reasonable and will be used in the income approach.

Capitalization Rate. The County proposes a capitalization rate of %%%%%, while the taxpayer proposes a rate of %%%%%. The County proffered five capitalization rate comparables that show that older office buildings, like the subject, sold between 2009 and 2011 at rates of %%%%%, %%%%%, %%%%%%, %%%%%, and %%%%%. The County did not know whether any of the properties has excess vacancy like the subject or whether the comparables were Class A, Class B, or Class C office buildings. In addition, the County did not know why four of its comparables sold at rates between %%%%% and %%%%%, while its fifth comparable sold at a much higher rate of %%%%%.

The County also submitted information showing that office buildings in the Salt Lake area sold at average capitalization rates ranging between %%%%% and %%%%% in 2010. Because the subject property has a history of excess vacancy, the County determined that its capitalization rate should be higher than the average rate. For these reasons, it estimated a rate of %%%%% for the subject.

The taxpayer provided March 2011 capitalization rate information for office buildings in the Salt Lake City area. The taxpayer contends that the information is based on the prior 12 months, which included the last

9 months of 2010. The information shows that Class A office buildings sell at lower capitalization rates than Class B and Class C buildings and that office buildings without excess vacancy sell at lower rates than buildings with excess vacancy. The information shows that office buildings like the subject (Class C with excess vacancy) sold at rates that ranged between %%%%% and %%%%%. Because the subject property has experienced a number of years of very high vacancy, the taxpayer proposes the high end of the range, %%%%%, for the subject property.

The information clearly shows that the subject's capitalization rate should be somewhere in between %%%%% and %%%%%. Neither party had a comparable that sold in this range. The County proffered a comparable that sold at an %%%%% rate on February 2011, one month after the lien date. As a result, the taxpayer's %%%%% proposed rate is better supported by a comparable than the County's %%%%% proposed rate. Because of the subject's history of excess vacancy, it is probable that its capitalization rate should be at the higher end of the range. For these reasons, an %%%%% rate will be used to determine the subject's value with the income approach.

Tenant Improvements. Both parties agree that the subject's value should be determined with a "stabilized" vacancy rate of %%%%% and that the short-term losses a buyer would expect to incur while the property leases up should be deducted from the stabilized value. The parties also agree on the methodology to determine the short-term losses for rent loss and commissions to deduct from the stabilized value. The parties, however, disagree on whether short-term losses for tenant improvements should also be deducted from the stabilized value.

The County contends that owners of office buildings rarely pay for tenant improvements. The taxpayer, however, explains that it has been paying for tenant expenses since 2008 (when the current managers took over) in an attempt to lease up the property. The taxpayer provided pictures to show that most of the vacant offices need carpeting and paint and explained that their costs to improve such space is typically around

$$$$$ per square foot. Because there were ##### square feet of excess vacancy as of the lien date, they ask the Commission to deduct $$$$$ in short-term losses for tenant improvements (approximately $$$$$ per square foot).

The owner of the subject property is paying most tenant improvements in an attempt to lease up the excess vacancy. For these reasons, the taxpayer's proposed tenant improvements expense of $$$$$ is more convincing than the County's proposed tenant improvements of $$$$$. A short-term loss of $$$$$ for tenant improvements will used to determine the subject's value with the income approach.

Commission's Income Approach. Based on the foregoing, the income approach reflects a value of $$$$$[2] for the subject property, as follows:

#####	Rentable Sq. Ft. of Main Floor
x $$$$$	Market Rent per Sq. Ft. of Main Floor
$$$$$	Potential Gross Income ("PGI") of Main Floor
#####	Rentable Sq. Ft. of 2nd Floor
x $$$$	Market Rent per Sq. Ft. of 2nd Floor
$$$$$	PGI of 2nd Floor
$$$$$	PGI (Total of $$$$$ for Main Floor and $$$$$ for 2nd Floor)
- $$$$$	Vacancy & Collection Losses (15% of PGI)
$$$$$	Effective Gross Income ("EGI")
- $$$$$	Reserves Expense (3% of EGI)
- $$$$$	Operating Expenses – Actual 2011 Expense Minus Property Taxes
$$$$$	Net Operating Income ("NOI")
÷ %%%	Capitalization Rate (%%%%% rate + %%%%% 2011 property tax rate)
$$$$$	Stabilized Value Derived with this Income Approach
- $$$$$	Minus Short-term Losses Associated with Excess Vacancy - Rent
- $$$$$	Minus Short-term Losses Associated with Excess Vacancy – Commissions
- $$$$$	Minus Short-term Losses Associated with Excess Vacancy - Tenant Improvements

2 The Commission has found for the taxpayer in regards to the three issues on which the parties disagreed. However, the Commission did not calculate the same $$$$$ value that the taxpayer calculated at the hearing. Part of the reason appears to relate to the taxpayer's 2011 expenses (once property taxes are deducted). The expense amount determined by the Commission from the taxpayer's evidence may be different from the amount that the taxpayer used after it deducted property taxes. For this reason and because the taxpayer has not submitted a document to show how it estimated its proposed value of $$$$$, the Commission finds that the income approach value is $$$$$.

$$$$$ Final Estimated Fair Market Value

The parties have clearly shown that the subject's current value of $$$$$ is incorrect. The taxpayer has submitted sufficient information to show that the subject's value should be nearer to its proposed value than to the County's proposed value. The subject's value should be reduced to $$$$$ for the 2011 tax year.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Tax Commission finds that the subject's value should be reduced to $$$$$ for the 2011 tax year. The Salt Lake County Auditor is ordered to adjust its records in accordance with this decision. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the taxpayer's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this ________ day of ________________________, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner