The Evaluator Summer 2023: Valuation Analysis

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California Appeals Court Affirms Assessor's Increase in Value Via Raise Letter Issued in Response to Owner's Reduction Request

***Rar2 Villa Marina Ctr. Ca Spe, Inc. v. L.A.*, No. B314898, 2023 BL 175455 (Cal. App. 2d Dist. May 23, 2023).**

The owners of a shopping center appealed from a judgment entered in a property tax refund action after the trial court upheld the decision of the Los Angeles County Assessment Appeals Board (Board) concerning the center's 2011 valuation. The property owners purchased the shopping center in 2006 for $100 million. In 2011, the County Assessor (Assessor) determined that the shopping center's valuation had decreased to approximately $94 million. The property owners filed a formal application seeking a further reduction to $48 million. In response to the reduction request, the Assessor issued three "raise letters" advising the property owners that the Assessor intended to introduce evidence at the Board's hearing to support an increase in value to approximately $113 million.

After several agreed extensions of the hearing date by both the Assessor and the property owners, the property owners requested that they be allowed to withdraw their application, accepting the original $94 million valuation. However, the Assessor opposed the withdrawal and the Board rejected the withdrawal request. After a hearing was held, the Board increased the assessment based upon the appraisal submitted by the Assessor. On appeal, the property owners asserted that the Assessor had no authority to issue a raise letter more than one year after the initial assessment.

The trial court determined that because the Assessor had issued a raise letter, the property owners could only withdraw their application with the Assessor's consent and that the Assessor's raise letter notifications were consistent with Board rules. The property owners appealed the trial court's determination.

On appeal, the Appeals Court determined that the original reduction complaint put the valuation of the property at issue and the Assessor gave proper notice of the Assessor's intent to present evidence of a higher valuation at the Board hearing. Additionally, the Court found that the statutory scheme vests with the Board the authority and obligation to determine the full value of the property, even if that value is higher than the initial valuation.

Ohio Budget Bill Establishes New Uniform Rules, Formula for Valuing Affordable Housing Projects

Ohio budget legislation (Budget Bill) signed in early July deleted a new statutory provision that had just become effective on April 7, 2023. Per the now-deleted provision, county auditors were permitted to determine the value of qualifying low-income housing tax credit (LIHTC) projects with any one or more of the market data approach, the income approach or the cost approach. This would have afforded county auditors significant discretion in valuing affordable housing projects and resulted in uncertainty across the state for LIHTC owners.

In its place, the Budget Bill created a new subsection (in R.C. Section 5715.01), which requires that the Tax Commissioner adopt uniform rules to determine the value of qualifying LIHTC projects. The new statute sets forth a detailed valuation formula that accounts for the following factors:

- **Operating Income**: Up to 3 years of operating income, including allowances for:
  - Vacancy: Presumed to be 4% of gross potential rent; and
  - Rental Losses: Presumed to be 3% of gross potential rent.

These presumptive amounts may be exceeded with evidence demonstrating the actual income of the property.

- **Operating Expenses**: Presumed to be 48% of operating income and includes:
  - Utility expenses as reported by the property owner; and
  - Replacement reserves or account contributions: Presumed to be 5% of gross potential rent.

Operating expenses do not include: real property taxes, depreciation and amortization expenses and replacement of short-term capitalized assets. These presumptive amounts may be exceeded with evidence demonstrating the actual expenses of the property.

- **Capitalization Rate**: Shall be a market-appropriate, uniform capitalization rate plus a tax additur accounting for the real property tax rate of the property's location. For properties operating under IRC Section 42, 1% is to be subtracted from the uniform capitalization rate.

The uniform rules shall also prescribe a minimum total value for LITHCs of $5,000 X the number of dwelling units comprising the property, or 150% of the property's unimproved land value, whichever is greater.

The new valuation provisions apply to "federally subsidized residential rental propert[ies]", which include properties receiving assistance pursuant to seven different federal provisions. In addition, property owners must file with the county auditor, both before a property is placed in service and by March 1st of each

following reporting year:(1) the operating income, including gross potential rent, any forgiveness or allowance due to unpaid rent, and any income from other sources; (2) the operating expenses including all non-capitalized expenses (and excluding real property taxes, depreciation, amortization and replacement of short-term capitalized assets); and (3) the annual contribution to replacement reserves or accounts. The information filed is not a public record. The information filed must have been first audited or updated within 30 days of the completion of the audit. If the information is not timely provided, the auditor does not have to value the property in accordance with the new valuation formula.

Missouri Tax Commission Rejects Appraiser's Reliance on Vacant and Soon-To-Be Vacant Retail Properties to Value Occupied Big Box Store.

***PTI FedWalko LLC Kohls v. Estes, Assessor of Cole Cty. Missouri*, STC No. 21-52001 (July 14, 2023).**

The Missouri Tax Commission (Commission) sustained the assessor's value of a big-box department store after rejecting the property owner's appraisal evidence. The property consists of 9.42 acres of land and is improved with a build-to-suit, one-story single tenant building of 88,554 square feet. The assessor determined a 2021 tax year value for the subject property of $6,704,600. The owner argued before the Commission that the correct value should be $5,327,000 and offered appraisal evidence in support. That report relied primarily on vacant or soon-to-be-vacant properties as comparables.

The Commission rejected the owner's approach. The Commission found that the owner excluded other build-to-suit properties and sale leasebacks in its analysis. "By rejecting the use of sale leasebacks or build-to-suit comparables, [the owner's appraiser] did not develop an accurate measure for the market value. [The Owner] presented no substantial and persuasive evidence indicating the property rights cannot be adjusted properly under USPAP standards or appraisal practice to the subject property. If the appraiser determines dollar adjustments are warranted for property rights, financing terms, conditions of sale, or market conditions, those adjustments can and should be made." The Commission further rejected the owner's theory that vacant properties offered for lease should be used as a measure of value because such a theory is not used by Missouri Courts to value property. Rather, Missouri statutes and case law prescribe that the leasehold interest has no impact on the transferability of the fee simple estate. Therefore, "[i]n most cases, the value of the leased fee and the value of the leasehold should approximate the value of the fee simple unencumbered by a lease." Because of the owner's heavy reliance on vacant property, the Commission concluded that the owner did not present sufficient comparables to support its requested decrease.

Texas Governor Signs Property and Franchise Tax Relief Bills

Governor Greg Abbot has signed Senate Bill 2, the property tax relief bill and Senate Bill 3, the franchise tax relief bill. These tax relief measures will go before Texas voters for approval at the November elections.

If approved by the voters, Senate Bill 2 and 3 will provide the following relief measures:

- The amount of the school district homestead exemption will increase from $40,000 to $100,000;
- For a limited time, all properties with a value of $5,000,000 or less will be entitled to a 20% cap on the increase in value from the preceding year's value beginning with the 2024 tax year. This cap is set to

expire year end 2026;

- School tax rates will be reduced by 10.7 cents per $100 in value by allocating $12 billion of the state's budget surplus to pay down school tax rates; AND
- Entities will not be required to file an information report for franchise taxes if the amount of tax would be less than $1,000 or if the total revenue of the entire business is less than $2,470,000. This increases the franchise tax exemption to $2.47 million.

Colorado Supreme Court Dismisses Taxpayers' Complaints Seeking Revaluation of Their Properties for Tax Year 2020 Because of the Covid-19 Pandemic and Subsequent Government Restrictions

In the Colorado Supreme Court – *MJB Motels LLC v. Jefferson County Board of Equalization et al.*, Case Number 2023 CO 26; *1303 Frontage Holdings LLC v. Larimer County Board of Equalization et al. v. Boeing Drive Investments LLC et al.*, Case Number 2023 CO 28; *Educhildren LLC et al. v. County of Douglas Board of Equalization et al.*, Case Number 2023 CO 29; and *Hunter Douglas Inc. v. City and County of Broomfield Board of Equalization et al.*, Case Number 2023 CO 27.

The Colorado Supreme Court recently issued decisions in four of the 11 coordinated cases brought by property owners seeking revaluation of their properties in 2020, an off cycle assessment year, as a result of the COVID-19 pandemic and subsequent government restrictions.

The property owners contended that the COVID-19 pandemic and subsequent government restrictions both constituted "unusual conditions" under Colorado's valuation statute, and, therefore, required assessors to revalue the properties in 2020, before the usual start of the revaluation cycle in 2021. The county assessors argued that no intervening year valuation was permissible because COVID-19 and the related government restrictions were not unusual conditions and they did not exist on the relevant assessment date, January 1, 2020.

In all four decisions, the Court held that COVID-19 was not a "detrimental act of nature" and the public health orders were not "regulations restricting the use of land." Accordingly, the assessors were not required to revalue the properties for tax year 2020 and the Court affirmed the district court order dismissing the complaints for failure to state a claim.

As was discussed at length during oral argument, the question of whether COVID-19 was an unusual condition was a threshold issue for the Court. In the four opinions, the Court noted that to fall within the exception, COVID-19 needed to be an act of nature and "in or related to any real property." In finding that COVID-19 was not an act of nature, the court compared it to an earthquake, flood, or tornado, which were the types of events typically encompassed by the act of nature to which the unusual condition exception applies. The Court also found that COVID-19 did not "infect the property itself."

The Court determined that the government regulations and public health orders were not regulations restricting the use of the land. The Court focused on the distinctions between land and improvements and noted that the public health orders restricted operation of commercial activity *on* the land, but not the use of land itself. The assessors and counties argued that the government restrictions and virus did not affect the use of the land. At the end of the opinion, the court also noted that while there may have been

economic impacts, such impacts would be reflected in the subsequent two-year reassessment cycles.

The Ohio Supreme Court Reverses the Strict Construction Rule of Statutory Tax Exemptions

***Stingray Pressure Pumping, L.L.C. v. Harris*, Slip Opinion No. 2023-Ohio-2598.**

The Ohio Supreme Court recently considered a sales and use tax exemption for fracking equipment, including a blender, a hydration unit, a chemical-additive unit, a sand king, a t-belt, and a data van. The taxpayer argued that the equipment qualifies for the statutory tax exemption because the equipment is used directly and is integral in the production of oil and gas. The Tax Commissioner denied tax exemption, finding that the equipment is not "directly used in injecting the high-pressure fracking fluid into the well." The Taxpayer appealed the finding to the Ohio Board of Tax Appeals (Board) where the Board affirmed the Tax Commissioner. While the case was pending, the General Assembly amended the sales/use tax exemption statute at issue. As set forth in the uncodified section of the house bill that amended the statute, the amendment was meant to be "a remedial measure intended to clarify existing law." The Board considered the clarifying amendment when it affirmed the Tax Commissioner's finding that the tax exemption did not apply. The Taxpayer appealed to the Ohio Supreme Court.

In considering the Taxpayer's appeal, the Court revisited its position regarding the statutory construction of tax exemption statutes, which the Court has declared on numerous occasions "must be construed against the taxpayer." The Tax Commissioner and the BTA have reiterated and applied this standard for decades. However, according to the Court, "such statements are in tension with our often-expressed commitment to apply the plain and ordinary meaning of statutory text." The Court went on to state that its "task is not to make tax policy but to provide a fair reading of what the legislature has enacted: one that is based on the plain language of the enactment and not slanted toward one side or the other." According to the Court: "Tax statutes must be read through a clear leans, not one favoring tax collection. Thus, we make clear today that henceforth we will apply the same rules of construction to tax statutes that we apply to all other statutes."

Applying a plain and ordinary meaning to the sales/use tax exemption and considering the amended E&P tax exemption statute, the Court held that all of the fracking equipment, except for the data van, is "directly used in performing hydraulic fracking services" and, thus, qualifies for tax exemption. The Court disagreed with the Tax Commissioner that the primary purpose of this equipment is to "hold" or "store" sand or chemicals, uses that would have been disqualifying of the tax exemption. The Court also held that the Board's reliance on earlier decisions supporting taxation of these pieces of equipment was legal error because those decisions applied a different version of the tax exemption statute. The Court was silent on the uncodified section of the statutory amendment that explained the amendment was clarifying overall and how prior law should be applied and it outright rejected the Tax Commissioner's argument that the amendment did not alter the Court's prior case law.

The Court's decision arguably broadens the sales/use tax exemption at issue beyond what the Legislature intended. This undoubtedly benefits taxpayers in the oil and gas industry. A more enduring result of this decision is that it upends decades of decisions in **all areas of tax**. The Tax Commissioner, the Board and the Court have for years "strictly construed" tax exemption statutes in all areas of tax against taxpayers and against granting tax exemptions. Taxpayers seeking real property tax exemptions have historically been

subject to this strict statutory application. The Court is absolutely clear in *Stingray* that tax exemption statutes are no different than any other statute and all should be plainly read without inference or deference to one party. Accordingly, taxpayers with pending real property tax exemption applications or who are considering filing new exemption applications should review and apply the Court's decision in *Stingray*.