

IN THE IOWA DISTRICT COURT FOR POLK COUNTY

VILLAGE GREEN CO-OP, INC.,

Petitioner,

vs.

POLK COUNTY BOARD OF REVIEW,

Respondent.

Case No. CV049982

**RULING AND ORDER ON PETITION
FOR JUDICIAL REVIEW**

This matter came before the Court on October 23, 2015, for oral argument in regard to the Petition for Judicial Review filed by the Petitioner, Village Green Co-Op, Inc., (“Village Green”) seeking judicial review of a ruling by the Iowa Property Assessment Appeal Board, (“PAAB”) filed on June 9, 2015. The Court, hearing the arguments of counsel and reviewing the court file, including the briefs filed by the parties and the certified administrative record, now enters the following ruling:

BACKGROUND FACTS AND PROCEEDINGS

In 2011, 2012, and 2013, PAAB made assessments of a Village Green Co-Op, Inc., (“Village Green”) property at East Seneca Avenue and East 14th Street, Des Moines, Iowa. The property is a multi-building, 128-unit housing complex constructed between 1961 and 1966. Village Green protested the 2011, 2012, and 2013 assessments, claiming they were too high.

The property's assessment was \$1,986,000 for 2011, 2012, and 2013, allocated as \$500,000 to land value and \$1,486,000 in improvement value. (Rec. at 2.) Village Green protested the initial 2011 assessment to the Polk County Board of Review contending it was assessed for more than authorized and the property was misclassified. Village Green protested the 2012 and 2013 assessments on the same grounds.

Richard Hickman ("Hickman"), owner and manager of Village Green properties, testified that Village Green purchased the subject property for \$1,815,000 and spends anywhere from \$70,000 to \$100,000 per year to continue operations. (*Id.* at 3.) Hickman indicated that about nineteen units were vacant to date and seven or eight units were delinquent on rent. Hickman also noted that the property turnover rate runs about 60% to 80% per year. (*Id.*) Hickman noted that Village Green spends \$300 per week on security for the particular property and has additional expenses for pest infestation.

The appraisals in question were completed by two independent appraisers, Ted Frandson ("Frandson") of Frandson & Associates, L.C., Des Moines, for Village Green and Gene Nelsen ("Nelsen") of Nelsen Appraisal Associates, Inc., Urbandale, for PAAB. (*Id.* at 4.) Typically, the sales comparison approach is used for apartment complexes, in addition to the income approach. Frandson was unable to find large complexes similar to the subject property and did not exclusively use the sales comparison approach; instead, he placed emphasis on the income approach to value the property.

Frandson used the income approach to evaluate four properties similar to the property in question. All of the properties compared were in Des Moines and, although they were in better locations, they were adequate comparisons for rental analysis based on the income approach. Frandson concluded the Gross Potential Income for the property is \$628,351. (*Id.* at 5.) Frandson

considered the property's actual vacancy and determined that the vacancy/collection loss of the stabilized gross potential income is 12% based on the property's historical and current vacancy. (*Id.*) Furthermore, Frandson discussed variable expenses including professional management services, noting that Village Green saves about \$30,000 by self-managing the property. (*Id.*)

As part of the income approach, Frandson analyzed an appropriate capitalization rate for the subject property. Frandson explained the best way to determine a capitalization rate is by looking at similar properties. He chose three properties and indicated that all three were superior to the subject property, thus resulting in lower capitalization rates. In addition, Frandson mentioned that surveys are helpful in determining capitalization rates when comparable sales are difficult to find. He relied on the first-quarter 2012 Real Estate Research Corporation survey, which provides a range of capitalization rates from 6.8% to 14% in the Midwest. (*Id.* at 7.) Based on the income approach, Frandson concluded that an appropriate capitalization rate is 14.6% for the subject property, the estimated value of the property is \$1,220,214, and he deducts \$26,684 for personal property, such as appliances, resulting in a final opinion value of \$1,194,000. (*Id.*)

Nelsen completed both the sales comparison and income approaches to value the subject property, concluding in a final opinion of value \$1,840,000. (*Id.*) Nelsen did not physically inspect the property but assumed that the property was in poor condition, similar to Frandson.

Nelsen selected five comparable apartment complexes for the sales analysis. The average price per unit fell between \$16,900 and \$38,000 for the five apartment complexes. (*Id.* at 8.) Although no property was exactly comparable to the Village Green property, the five complexes provided a mixture of older properties, a variety of locations, and a variety of vacancies and renovations. Sales in the five complexes ranged from \$13,436 to \$15,500 per unit, which led

Nelsen to determine a per-unit value of \$14,500 or \$1,860,000 for the entire Village Green property. (*Id.* at 12.)

Nelsen determined the market rent of the property by analyzing the property's rent roll and surveys of the property. Furthermore, Nelsen developed a reconstructed operating income statement. He concluded that the expenses for the subject property were 60% of the effective gross income, while average expenses in Des Moines were 51% of the effective gross income. (*Id.* at 12-13.) Nelsen built many additional expenses into his analysis; accounting for expenses that Frandson separated into separate accounts.

Finally, Nelsen concluded that an appropriate capitalization rate would be 12.60%, including a tax adjustment of 4%. (*Id.* at 14.) He based this conclusion on a mortgage equity technique, an investor survey, and the sales comparison analysis, which provided capitalization rates of 7.85%, 5.80% to 5.98%, and 8.5% to 9.1%, respectively. (*Id.*) Nelsen arrived at 12.60% by factoring in the tax liability on the property, which was an additional 4%. (*Id.*) Nelsen's estimated value of the Village Green property was \$1,840,000 before appliance deductions and \$1,813,000 after appliance deductions, which is his final opinion of value. (*Id.*)

PAAB began its review by analyzing the sales comparison approach used by Nelsen. The Board agreed with Village Green's argument that substantial adjustments to comparable sales may indicate a lack of comparability; however, they noted that Village Green's appraiser, Frandson, did not attempt to make adjustments to comparable sales but still used apartment sales in the market rate and capitalization rate analysis. (*Id.* at 15-16.)

The Board found that the condition of the subject property may limit the availability of identical comparable sales but does not make the property entirely unique. (*Id.* at 16.) The Board noted that there are comparable sales to aid the sales comparison approach and Frandson's

failure to develop this approach limits the accuracy of his appraisal. (*Id.*) Even though the Board notes Frandson's approach is limited, they give weight to Frandson's use of the income approach because the subject property suffers from challenges including pest infestations, security problems, and vacancy issues, which makes finding comparable properties difficult. (*Id.* at 17.)

"The Board notes that Nelsen developed both the income and sales comparison approaches to value." (*Id.* at 17.) The Board indicates that Nelsen's sales comparison approach analyzed five comparable properties, which had similar unit counts, style, and location to the Village Green property. (*Id.*) Two of the complexes had similar or worse vacancy rates than the Village Green property.

Furthermore, the Board notes that Nelsen was unable to complete an interior inspection of the property. (*Id.*) The Board found that Nelsen described the property to be in below-average condition, which is consistent with Frandson's inspection; therefore, the Board found that Nelsen's failure to inspect the interior was harmless. Additionally, the Board concluded that Frandson's inspection was limited because of a bed bug infestation and, thus, his inspection was not fully complete. (*Id.*)

The Board explains that Nelsen's conclusions are more reliable, in part because his expense ratios were more in line with Des Moines norms. (*Id.* at 18.) Nelsen estimated expenses were at 60% before taxes, compared to 51% average expenses in Des Moines. Conversely, Frandson concluded that an appropriate expense ratio would be closer to 84%, a figure the Board found to be too high, based on city norms. (*Id.*)

Finally, the Board found Nelsen's conclusions on capitalization rates to be more reliable. (*Id.*) Frandson determined a capitalization rate of over 10% would be appropriate due to the property's location, condition, and vacancy rates. The Board disagreed and found that many of

the additional expenses used by Frandson's analysis were also considered by Nelsen and used in his valuation. (*Id.* at 19.). In addition, the Board found Frandson's use of the subject property's location, condition, and occupancy rates was misplaced in finding a higher capitalization rate. (*Id.* at 19.) The Board placed considerable emphasis on Nelsen's attempt make adjustments to comparable properties and his use of average capitalization rates when calculating his valuation.

The Board found that Nelsen's appraisal was the best evidence of the fair market value of the subject property and established it was over-assessed. (*Id.*) The Board required Nelsen to reduce his conclusion by \$26,684 to account for personal property associated with the property. The final estimate was \$1,813,000. (*Id.*)

On July 15, 2015, Village Green filed an amended petition for judicial review challenging PAAB's ruling. (Pet. at ¶ 14.) On August 5, 2015, Village Green filed their Brief in Support of their Petition for Judicial Review. (Pet.'s Br. at 1.) On September 11, 2015, PAAB filed their Reply Brief. (Resp't's Br. at 1.)

STANDARD OF REVIEW

Chapter 17A of the Iowa Code governs judicial review of administrative agency action. The district court acts in an appellate capacity to correct errors of law on the part of the agency. *Meyer v. IBP, Inc.*, 710 N.W.2d 213, 219 (Iowa 2006). The Court "may grant relief if the agency action has prejudiced the substantial rights of the petitioner, and the agency action meets one of the enumerated criteria contained in section 17A.19(10)(a) through (n)." *Burton v. Hilltop Care Cntr.*, 813 N.W.2d 250, 256 (Iowa 2012) (quoting *Evercom Sys., Inc. v. Iowa Utilities Bd.*, 805 N.W.2d 758, 762 (Iowa 2011)). Where an agency has been "clearly vested" with a fact-finding function, the appropriate "standard of review [on appeal] depends on the aspect of the agency's decision that forms the basis of the petition for judicial review"—that is, whether it involves an

issue of 1) findings of fact, 2) interpretation of law, or 3) application of law to fact. *Burton*, 813 N.W.2d at 256.

“If the claim of error lies with the agency's findings of fact, the proper question on review is whether substantial evidence supports those findings of fact.” *Meyer*, 710 N.W.2d at 219. “[A] reviewing court can only disturb those factual findings if they are ‘not supported by substantial evidence in the record before the court when that record is reviewed as a whole.’” *Burton*, 813 N.W.2d at 256 (quoting Iowa Code § 17A.19(10)(f)). A district court’s review “is limited to the findings that were actually made by the agency and not other findings that the agency could have made.” *Id.* However, “[i]n reviewing an agency's finding of fact for substantial evidence, courts must engage in a ‘fairly intensive review of the record to ensure that the fact finding is itself reasonable.’” *Neal v. Annett Holdings, Inc.*, 814 N.W.2d 512, 518 (Iowa 2012) (quoting *Wal-Mart Stores, Inc. v. Caselman*, 657 N.W.2d 493, 499 (Iowa 2003)).

“Substantial evidence means the quantity and quality of evidence that would be deemed sufficient by a neutral, detached, and reasonable person, to establish the fact at issue when the consequences resulting from the establishment of that fact are understood to be serious and of great importance.” Iowa Code § 17A.19(10)(f)(1). If “the claim of error lies with the agency's interpretation of the law, the question on review is whether the agency’s interpretation was erroneous, and we may substitute our interpretation for the agency’s.” *Meyer*, 710 N.W.2d at 219.

If “the claim of error lies with the *ultimate conclusion* reached, then the challenge is to the agency's application of the law to the facts, and the question on review is whether the agency abused its discretion by, for example, employing wholly irrational reasoning or ignoring important and relevant evidence.” *Meyer*, 710 N.W.2d at 219. In other words, the Court will only

reverse the Commissioner's application of law to the facts if "it is 'irrational, illogical, or wholly unjustifiable.'" *Neal*, 814 N.W.2d at 518 (quoting *Lakeside Casino v. Blue*, 743 N.W.2d 169, 173 (Iowa 2007)); *see also* *Burton*, 813 N.W.2d at 256 ("When the application of law to fact has been clearly vested in the discretion of an agency, a reviewing court may only disturb the agency's application of the law to the facts of the particular case if that application is 'irrational, illogical, or wholly unjustifiable.'").

ANALYSIS

A. Total Expenses

Village Green argues that Nelsen made a mistake by not using actual expenses in his effective gross income estimate, but on what he believed were average statistical expenses.

Village Green contends that Frandson used actual expenses of \$396,625, resulting in a correct effective gross income estimate.

"All property subject to taxation shall be valued at its actual value" Iowa Code § 441.21(1)(a) (2015). "The actual value of all property subject to assessment and taxation shall be the fair and reasonable market value of such property except as otherwise provided in this section." *Id.* § 441.21(b)(1).

"Market value" is defined as the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each being familiar with all the facts relating to the particular property. Sale prices of the property or comparable property in normal transactions reflecting market value, and the probable availability or unavailability of

persons interested in purchasing the property, shall be taken into consideration in arriving at its market value.

Id. §441.21(b)(1).

PAAB argues that the use of objective income such as market rent and expenses is appropriate given that this is not a property governed by section 42 of the Internal Revenue Code. Under section 42, the assessor shall use the productive and earning capacity from the actual rents received when the property is a low income housing property. *Id.* § 441.21(2). The Board analyzed the condition of the property noting that it is below normal condition; however, they did not conclude that the property fell under section 42. Therefore, the Board analyzed the appraisals for their relation to the market.

The actual value of a property is the fair and reasonable market value of the property. *Id.* § 441.21(b)(1). PAAB argues that the appraiser must develop operating expense ratios from comparable properties in the subject property's market. To do this, the appraiser must look at comparable properties in the area. The issue of comparability has two components: the property used for comparison must be "comparable: and its sale must be a "normal transaction." *Soifer v. Floyd Cnty Bd. of Review*, 759 N.W.2d 775, 782 (Iowa 2009). The Board noted that "the condition of the subject property limits the availability of *identical* sales, we do not believe the subject is so unique that comparisons could not be made to other complexes...." (PAAB Ruling p. 16.) *Sears, Roebuck & Co. v. Sieren*, 460 N.W.2d 887, 890 (Iowa Ct. App. 1990). The Board further ruled that there are sufficient comparable sales to make a sales comparison and Frandson's failure to develop an approach related to comparable sales, limits the reliability and credibility of his analysis.

Village Green argues that the property was “far below normal investment grade property.” (Pet. Br. p. 11.) Frandson looked for sales but was unable to find large complexes like the subject. The Board noted that the properties Frandson was able to find were in significantly better location, condition, and quality. Nelsen’s comparable properties were not identical to the subject property; however, they exhibited similar characteristics including depressed condition, vacancy, overall size, and age. Since the Board did not require identical comparisons, they concluded that Nelsen’s approach was the most complete because he attempted to adjust selected comparable properties to the subject property while Frandson failed to consider similar properties.

The Board concluded that Nelsen was not required to use actual expenses in his property assessment. Nelsen attempted to make comparisons to similar properties by adjusting for different locations, rents, and conditions. The Board indicated that the comparable properties need not be identical and found Nelsen’s analysis to be more complete. Since the Board favors a market analysis approach that emphasizes the use of comparable properties, their conclusion that Nelsen’s appraisal was more credible and reliable because he examined comparable sales is supported by substantial evidence. Iowa Code § 17A.19(10)(f).

B. Capitalization Rate

The Board also gave consideration to the income approach to value as an additional mechanism to analyze the property value of the subject property. (PAAB Ruling p. 17.) *See Wellmark, Inc v. Polk Cnty Bd. of Review*, No. 14–0093, 2015 WL 1815991, at *3 (Iowa Ct. App. Apr. 22, 2015) (where the income approach was used in place of the comparable sales approach). Village Green argues that the Board erred in not applying a 10% capitalization rate.

Nelsen concluded that a capitalization rate of 8%, plus a tax adjustment of 4%, was appropriate given the property's location, vacancy, and condition. In general, capitalization rates are determined by examining comparable sales and extracting the relevant rates. *Eagle Food Ctrs, Inc. v. Bd. of Review of City of Davenport, Scott Cnty.*, 497 N.W.2d 860, 863 (Iowa 1993). In addition, national or regional averages can be used to determine an appropriate capitalization rate. Comparable sales, national, and regional averages can provide an accurate basis for a capitalization rate because the rate is a reflection of the perceived risk of the property. *See THE APPRAISAL OF REAL ESTATE* 457 (14th ed.). "The income approach is used to determine value based upon the property's expected ability to generate income for the owner, accounting for the property's estimated gross rents, vacancy rates, and anticipated operating expenses." *Wellmark, Inc.*, 2015 WL 1815991, at *4 (where the Midwest tertiary market rate was used to find the appropriate capitalization rate).

Nelsen examined capitalization rates in Des Moines, the national average, and the Midwest. Nelsen found the capitalization rates in Des Moines ranged from 8.5% to 9.1%. The national average was near 6% in 2011 and the rates in the Midwest ranged from 6.8% to 14% during that time. Nelsen also completed a mortgage equity analysis, which indicated a capitalization rate of 7.85%. Based on this data, Nelsen concluded that an appropriate capitalization rate for the subject property was around 8%.

Village Green argues that this conclusion is not supported by substantial evidence and the conclusion from Frandson should be used. Frandson concluded an appropriate capitalization rate was near 10%. Frandson based this conclusion on testimony from Richard Hickman, Village Green property owner, who said that he believed the capitalization rate should be 10% to 12%. Also, Frandson indicated that a rate of 10% was justified given the poor condition, turnover, and

vacancy issues of the property. Village Green argues that this conclusion is supported by substantial evidence because Frandson was able to inspect the property while Nelsen was not. PAAB acknowledged Village Green's concern but concluded that Nelsen did account for the property's poor condition despite not performing an interior inspection of the subject property. Nelsen accounted for differences between the subject property and comparable property with regard to location, quality, and size. Furthermore, the board concluded that Frandson's inspection was limited due to a bed bug infestation. The board concluded that Frandson's inspection was not significantly more developed than Nelsen's and that Nelsen's capitalization rate conclusions were supported by substantial evidence because he analyzed the subject property to the Des Moines, national, and regional averages.

The Court finds that there is substantial evidence in the record to support PAAB's ruling that Nelsen's appraisal is the best evidence of the fair market value of the subject property. Iowa Code § 17A.19(10)(f). Nelsen based his conclusion on comparable properties and the income approach. In selecting comparable properties, Nelsen recognized that no property would be identical so he made appropriate adjustments to various properties due to their age, condition, size, location, and vacancy. In developing the income approach, Nelsen analyzed Des Moines, national and regional capitalization rates. In addition, although Nelsen did not extensively inspect the property, he took the property's condition into consideration in developing his final conclusion. While there may be record evidence to support a contrary conclusion, there is substantial evidence to support the conclusion actually reached by the agency. Under such circumstances, the agency must be affirmed.

ORDER

IT IS THEREFORE THE ORDER OF THIS COURT that the ruling of the Iowa Property Assessment Appeal Board, filed May 27, 2015, is hereby AFFIRMED.



State of Iowa Courts

Type: OTHER ORDER

Case Number CVCV049982
Case Title VILLAGE GREEN CO-OP INC V IOWA PROPERTY ASSESSM

So Ordered

A handwritten signature in black ink, reading 'Robert A. Hutchison'. The signature is written in a cursive style and is positioned above a horizontal line.

Robert A. Hutchison, District Court Judge,
Fifth Judicial District of Iowa