

STATE OF IOWA
PROPERTY ASSESSMENT APPEAL BOARD

Care Initiatives,
Petitioner-Appellant,

v.

Guthrie County Board of Review,
Respondent-Appellee.

ORDER

Docket No. 11-39-0080
Parcel No. 00054-0001290800

On September 24, 2012, the above-captioned appeal came on for hearing before the Iowa Property Assessment Appeal Board. The appeal was conducted under Iowa Code section 441.37A(2)(a-b) and Iowa Administrative Code rules 701-71.21(1) et al. Petitioner-Appellant, Care Initiatives, was represented by attorney Deborah M. Tharnish of Davis Brown Law Firm of Des Moines. The Board of Review was represented by attorney Brett Ryan of Watson & Ryan, PLC, Council Bluffs. Both parties submitted evidence in support of their position. The Appeal Board now having examined the entire record, heard the testimony, and being fully advised, finds:

Findings of Fact

Care Initiatives appeals from the Guthrie County Board of Review decision reassessing its property located at 805 East Main Street, Panora, Iowa. According to the property record card, the subject property consists of a 33,821 square-foot, one-story nursing home built in 1972 and an attached 9267 square-foot, assisted-living center built in 2007. It has a total gross building area of 43,088 square feet. The real estate was classified as commercial for the assessment of January 1, 2011, and valued at \$1,792,132, representing \$50,888 in land value and \$1,741,244 in improvement value.

Care Initiatives protested to the Board of Review on the ground that the property is misclassified under Iowa Code section 441.37(1)(a)(3). It asserted the property's classification should be residential. The Board of Review denied the petition.

Care Initiatives then appealed to this Board and reasserted its claim. It relies on Iowa Code section 441.21(11) and the holding in *Evangelical Lutheran Good Samaritan Society v. Board of Review of the County of Montgomery*, 688 N.W.2d 482 (Iowa App. 2004), as the basis for its request for residential classification. It does not challenge the assessed value of the subject property.

At hearing, counsel for the parties stipulated that (1) Care Initiatives is a 501(c)(3) non-profit organization¹ and (2) Care Initiatives had no unrelated business income.² Thus, the issue on appeal is narrowed to whether the property is used primarily for human habitation. Care Initiatives asserts its primary use is for human habitation. The Board of Review, however, contends the property is primarily used for providing commercial services.

Steve Marlow, Vice President and Chief Financial Officer for Care Initiatives, testified on its behalf. Marlow stated the organization owns forty-four skilled nursing homes/rehabilitation centers, assisted living facilities, and independent living facilities in numerous Iowa communities. Marlow reports these non-profit facilities serve mainly the elderly and infirm in home-like settings that provide for socialization, meals, and activities of day-to-day living. Marlow reported that of Care Initiative's forty-four skilled nursing homes in Iowa, thirty-five or thirty-six have been re-classified residential. The Panora facility is licensed for 91 skilled nursing beds and 11 assisted living beds. Marlow considers the subject property a dwelling for the residents. Marlow said, "It's their home." It is where they eat, sleep, socialize, and participate in activities of daily living.

Marlow reports the Panora facility has private, semi-private, and ward rooming with private or shared bathrooms. The facility also has a common bathing area. Additionally, there are common areas

¹ Care Initiatives submitted a letter from the Internal Revenue Service (IRS), dated July 18, 1996 (Exhibit 4). The letter determined Care Initiatives qualified as a section 501(c)(3) organization.

² Care Initiatives filed IRS Form 990 – Return of Organization Exempt From Income Tax (Exhibit 3) for Care Initiatives, Inc. for calendar year 2009. The return shows the corporation had no unrelated business taxable income from a Form 990-T (Exhibit 3, pp. 1 & 9).

for dining, cooking, and socialization. There are also three dedicated therapy rooms and two central nursing stations.

Residents are covered by Medicare, Medicaid, or are private pay. He explained that Medicare residents are limited with each stay to 100 days, including twenty-one days of hospitalization, and there is more turnover in this population. These individuals stay for shorter periods mainly to improve the quality of their life and with a goal of returning to their primary home. Marlow reports nine Medicare individuals might reside in the same room at different times during the year. The average Medicare stay is 40 days and this shorter stay inflates the discharge rates. Medicaid and private pay residents, however, stay indefinitely and are most likely to live the rest of their life in the nursing home. Medicaid residents account for 50% of the total population, private-pay individuals account for 40% of the population, and 10% of the residents are covered by Medicare. Marlow estimates approximately 90% (50% Medicaid & 40% private-pay), will likely live the remainder of their life at the facility.

The facility also provides speech services and occupational and physical therapy to residents as well as to non-resident individuals. The services offered to non-resident individuals are limited. Of the total \$2.5 to \$3 million in revenue at Panora, approximately \$50,000 is from therapy provided to non-residents. The facility also has one room dedicated to hospice use. The facility is not licensed as an adult day care center, but can accommodate one adult in day care status per day. Marlow did not know whether this service had ever been used. We find these incidental uses (out-patient therapy and adult-day care) are insignificant as compared to the central use of the property. Additionally, it would appear the purpose of hospice fits within a residential use because, in addition to providing end-of-life care for terminally ill individuals, it also provides them with a residence until the end of their life.

Care Initiatives also provided a series of email communications and policy statements from the Iowa Department of Revenue (IDR) (Exhibits 5-7). These documents indicate IDR's position

regarding the classification of property under the statute at issue. The emails occurred in approximately May 2011. Cary Halfpop, Chief Appraiser in the Property Tax Division at IDR, indicated in the letter that if nursing home properties and/or assisted living facilities are owned by a 501(c)(3) organization, are used primarily for human habitation, and if the rental income from the property is not taxed as unrelated business income, they should be classified residential. In a follow-up email, Halfpop recommends seeing the 501(c)(3) documentation and reiterates the position that these properties should be classified residential. (Exhibit 7). Care Initiatives also submitted a copy of *Care Initiatives v. Lyon Co Board of Review*, Docket No. 11-60-0074 (Exhibit 8), in which this Board held a nursing home owned by Care Initiatives should be classified residential.

Appraiser Ted R. Frandson of Frandson & Associates, L.C. in Des Moines completed a use analysis report (Exhibit 9) and testified at hearing on Care Initiatives' behalf. Frandson reviewed the subject property's site plans, took measurements, and physically inspected it in July 2012. In the report, he determined the area and percent of the improvements that would be used for human habitation. Frandson included the area that would be needed for a person to live in a more traditional residential setting, such as the living quarters/bedrooms, the common kitchen and dining areas, and the common baths/showers. He also included the common living room/TV rooms. Frandson excluded offices, nurse's stations, drug storage rooms, therapy or examination rooms, storage closets, medical records storage, mechanical or service areas, and HVAC mechanicals, and laundry facilities. Using these criteria, he determined 83.5% of the property was used for habitation and 16.5% of the property was used for non-habitation support area. Based on this finding, Frandson concluded the property was primarily used for human habitation.

Frandson did not complete an income analysis because, in his opinion, an income analysis is not necessary to determine use. He explains the rooms cannot be individually rented out without the nursing care component and there is not a comparable market for this type of use. He commented that

he could not find a reliable way to do such an approach. Frandson also noted it is virtually impossible to look at total revenue and separate out the habitation portion because the revenue also includes the costs of services and staff. Frandson reports observed use, not income, is considered the best analysis to determine habitation use and that this test is straightforward.

Appraiser Robert Ehlers of Vanguard Appraisals, Inc. in Cedar Rapids completed a use analysis report (Exhibit A) and testified for the Board of Review. Ehlers inspected the subject property in March 2012. In the report, he completed a use analysis as well as an income analysis to determine whether the primary use of the property was for human habitation or for commercial nursing care. First, we note Ehlers's report relied on data that was extremely dated; some nursing home statistics were over twenty years old.

In his use analysis, Ehlers attempted to discern a difference between the residents' private living area and other common areas. To delineate the two types of use, Ehlers relied on "industry standards" for condominiums and apartments. He determined, using these two types of properties, that excluding common areas in his calculation of area used for human habitation was appropriate. Based on this determination, Ehlers essentially only measured the residents' individual rooms as space used for human habitation. He excluded what he termed "limited common area" and "communal area" from habitation area. These areas included the communal bath area, the dining room, the kitchen, the recreation room, as well as all of the hallways connecting various parts of the facility. He also excluded the therapy rooms, nurses stations, and, essentially, all other areas of the facility. Using these parameters, Ehlers determined only 44.36% of the property was used for human habitation. He further determined the remaining 55.64% of the property was used for the care and treatment of the residents, not human habitation. Applying this reasoning, Ehlers concluded the property was being used for commercial purposes.

Ehlers completed an income analysis because he believed the step was necessary in considering the property's highest and best use, which is an appraisal theory. Ehlers determined market rent for only the bedroom/apartment portion of the property, which he called "rentable living area" or "rentable sleeping rooms," using statistics from several low income and elderly housing projects across the state. He conceded the market data may include section 42 and section 8 low rent housing rents. He estimated the property could theoretically yield \$308,100 gross rental income annually, while its actual gross revenue was over \$3,000,000 from 2008 to 2010. By this method, Ehlers concludes *the primary function* of the property is to operate a skilled nursing and assisted living facility, since less than 5% of the revenue is generated by human habitation.

Ehlers also testified he believed the property was used primarily for commercial rather than residential purposes because some of the residents still own private homes on which they claim homestead credit. He questioned how this can be their primary residence if they are still collecting this credit on other property.

The flaws in Ehlers' use analysis became apparent on cross-examination. First, Ehlers admitted that an individual can own more than one residentially classified property and claim a homestead credit on one of them. Ehlers was also asked to define what he considered to be necessary for basic human habitation. At first he declined to do so. His report, however, defines activities of daily living to include "the most frequent and basic activities of human life such as bathing, dressing, going to the toilet, eating, and ambulation." (Exhibit A, p. 7). His appraisal acknowledges eating is a basic activity of human life, yet Ehlers excluded both the kitchen and dining room from his "human habitation" determination. He further admitted he had never appraised a home that did not include a place to eat or prepare food. Finally, he admitted that including the dining room and the hallways as residence space would likely result in more than 50% of the property being used for human habitation.

Ehler's income analysis was also flawed. Even though his report indicated both income and expenses would be considered, his final analysis did not address any expenses. Ehlers knew little about the properties he used as comparables, and it would appear these properties are not like the subject. On cross-examination he declined to answer questions, or if he did answer them, he gave vague or indirect responses. Based on the sum of his testimony and his report, we did not find Ehlers credible.

Conclusion of Law

The Appeal Board applied the following law.

The Appeal Board has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2011). This Board is an agency and the provisions of the Administrative Procedure Act apply to it. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). The Appeal Board determines anew all questions arising before the Board of Review related to the liability of the property to assessment or the assessed amount. § 441.37A(3)(a). The Appeal Board considers only those grounds presented to or considered by the Board of Review. § 441.37A(1)(b). But new or additional evidence may be introduced. *Id.* The Appeal Board considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption that the assessed value is correct. § 441.37A(3)(a).

In Iowa, property is to be valued at its actual value. Iowa Code § 441.21(1)(a). Actual value is the property's fair and reasonable market value. § 441.21(1)(b). "Market value" essentially is defined as the value established in an arm's-length sale of the property. *Id.* Sale prices of the property or comparable properties in normal transactions are to be considered in arriving at market value. *Id.* If sales are not available, "other factors" may be considered in arriving at market value. § 441.21(2). The assessed value of the property shall be one hundred percent of its actual value. § 441.21(1)(a).

Care Initiatives asserts its property is misclassified and its actual classification should be residential. Iowa Code section 441.21(11) designates that properties meeting certain criteria to be classified as residential real estate. It states:

Beginning with valuations established on or after January 1, 1995, as used in this section, “residential property” includes . . . land and buildings used primarily for human habitation which land and buildings are owned and operated by organizations that have received tax-exempt status under section 501(c)(3) of the Internal Revenue Code and rental income from the property is not taxed as unrelated business income under section 422.33, subsection 1A.

Additionally, the Iowa Department of Revenue has promulgated rules for the classification and valuation of real estate. *See* Iowa Admin. Code Ch. 701-71.1. Classifications are based on the best judgment of the assessor exercised following the guidelines set out in the rule. *Id.* Boards of Review, as well as assessors, are required to adhere to the rule when they classify property and exercise assessment functions. r. 701-71.1(2). Classification is based on the property’s present use and not its highest and best use. r. 701-71.1(1). There can be only one classification per property. *Id.*

Iowa Administrative rule 701-71.1(4), related to the classification of residential real estate, states that properties owned and operated by section 501(c)(3) organizations are classified as residential real estate. It states:

Residential real estate shall include all lands and buildings which are primarily used or intended for human habitation, . . . [And] land and buildings owned and operated by organizations that have received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, if the rental income from the property is not taxed as unrelated business income under Iowa Code section 422.33(1A), shall be considered residential real estate.

Conversely, commercial real estate

shall include all lands and improvements and structures located thereon which are primarily used or intended as a place of business where goods, wares, services, or merchandise is stored or offered for sale at wholesale or retail. [...] However, regardless of the number of separate living quarters or any commercial use of the property . . . land and buildings used primarily for human habitation and owned and operated by organizations that have received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, if the rental income from the property is not taxed as unrelated business income under Iowa Code section 422.33(1A), shall be classified as residential real estate.

Iowa Admin. r. 701-71.1(5).

As stipulated by the parties, Care Initiatives is a 501(c)(3) organization and its income from the property is not taxed as unrelated business income. Thus this Board needs only to determine whether the property is used primarily for human habitation, in contrast to “property primarily used or intended as a place of business where goods, wares, services, or merchandise is stored or offered for sale at wholesale or retail.” r. 701-71.1(5). This issue has been addressed by the Iowa Supreme Court in *Evangelical Lutheran Good Samaritan Soc. v. Bd. of Review*, 688 N.W.2d 482, 491 (Iowa App. 2004). The Court held that an eighty-eight bed, non-profit, skilled-nursing facility in Red Oak, Iowa, met the statutory definition of residential property. It determined the property was “used primarily for human habitation, in contrast to ‘property primarily used or intended as a place of business where goods, wares, services, or merchandise is stored or offered for sale.’” *Id.*

In this case, Frandon’s use analysis is unquestionably more reliable than Ehlers’ analysis. Although Ehlers based his use analysis on industry standards for apartments and condominiums, the subject property is inherently different. Unlike apartments or condominiums, residents’ rooms in the subject property do not contain kitchens, dining rooms, or living rooms. We find Ehlers’ failure to consider portions of the property necessary for the residents to carry on activities generally associated with daily, residential living was in error. Cooking, eating, bathing, socializing, and moving from one place to another are standard activities associated with daily living and areas utilized for these activities ought to be considered as used for human habitation.

Ehlers use of an income analysis is also questionable. He indicated part of his reason for completing such an analysis is because it was necessary to consider the subject property’s highest and best use; however, we note highest and best use cannot be considered when determining classification. Moreover, the properties Ehlers used for market rents in his analysis had questionable comparability to

the subject property and his method for applying market rents to the property was illogical. We find Frandson's testimony, that there essentially was no reliable way to do such analysis, more sound.

The subject property houses elderly and infirm individuals. In addition to being the "home" of these individuals, it provides services to them that one would enjoy in their own home, including meals and recreation. It also provides medical services necessary for them to maintain and sustain their life. Despite the somewhat commercial nature of the medical services, their availability does not overshadow the property's use for human habitation. The commercial classification rule specifically notes an exception when there is an existing commercial use.

"Regardless of ... any commercial use of the property the buildings used primarily for human habitation and owned and operated by organizations that have received tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, if the rental income from the property is not taxed as unrelated business income under Iowa Code section 422.33(1A), shall be classified as residential real estate.

Iowa Admin. r. 701-71.1(5) (emphasis added).

Even though the Board of Review spent considerable time questioning the length of stay of some of the residents and noted that some may claim homestead credits on other residences, we do not believe these facts resolve the issue in the Board of Review's favor. As the Court noted in *Evangelical Lutheran*, "nothing in the statutory definition or the administrative code relating to homestead exemptions or the length of residence" affect[s] the classification of the property as residential or commercial." 688 N.W.2d at 491. Additionally, nothing in the statute requires residents to claim this property as their primary residence for it to be considered used primarily for human habitation. The only logical conclusion to draw in this case is that the primary use of the subject property is for human habitation. This determination complies with the holding in *Evangelical Lutheran*, and with the law that it interprets.

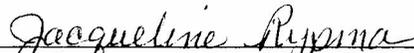
Following Iowa law and administrative rules governing the classification of real estate, we find the Care Initiatives' property falls squarely within the residential classification. The preponderance of

the evidence in the record demonstrates Care Initiatives' property is: (1) used primarily for human habitation; (2) its land and buildings are owned and operated by an organization that has received tax-exempt status under section 501 (c)(3) of the Internal Revenue Code; and (3) its rental income from the property is not taxed as unrelated business income under section 422.33, subsection 1A, as of January 1, 2011.

THE APPEAL BOARD ORDERS that the January 1, 2011, assessment of the Care Initiatives' property located at 805 East Main Street, Panora, Iowa, is modified by changing its classification to residential. The assessed valuation of \$1,792,132, representing \$50,888 in land value and \$1,741,244 in improvement value remains unchanged.

The Secretary of the State of Iowa Property Assessment Appeal Board shall mail a copy of this Order to the Guthrie County Auditor and all tax records, assessment books and other records pertaining to the assessment referenced herein on the subject parcel shall be corrected, accordingly.

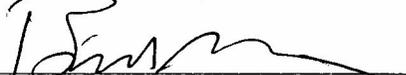
Dated this 5 day of November, 2012.



Jacqueline Rypma, Presiding Officer



Karen Oberman, Board Member



Richard Stradley, Board Chair

Copies to:
Deborah M. Tharnish
Davis Brown Law Firm
215 10th Street, Suite 1300
Des Moines, IA 50309
ATTORNEY FOR APPELLANT

Brett Ryan
Watson & Ryan
535 West Broadway, Ste. 200
P.O. Box 646
Council Bluffs, IA 51502
ATTORNEY FOR APPELLEE

Jerri Christman
Guthrie County Auditor
200 N. 5th
Guthrie Center, IA 50115
AUDITOR

Certificate of Service	
The undersigned certifies that the foregoing instrument was served upon all parties to the above cause & to each of the attorney(s) of record herein at their respective addresses disclosed on the pleadings on <u>11-5</u> , 201 <u>2</u>	
By:	<input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> FAX
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