BOARD OF ASSESSMENT APPEALS, STATE OF COLORADO 1313 Sherman Street, Room 315 Denver, Colorado 80203 Petitioner: **DENVER HIGHLANDS LTD PARTNERSHIP ETAL AND MB HIGHLANDS RANCH RIDGELINE LLC,** v. Respondent: **DOUGLAS COUNTY BOARD OF EQUALIZATION.**	**Docket Nos.: 50112 & 50781**
ORDER	

THIS MATTER was heard by the Board of Assessment Appeals on September 10, 2009 Louesa Maricle, Debra A. Baumbach and Sondra W. Mercier presiding. Petitioner was represented by Richard G. Olona, Esq. Respondent was represented by Robert D. Clark, Esq. Petitioner is protesting the 2007 and 2008 actual value of the subject property.

PROPERTY DESCRIPTION:

Subject property is described as follows:

8822 Ridgeline Boulevard, Highlands Ranch, Colorado
(Douglas County Schedule No. R0330068)

The subject is an 85,860 square foot office building that was completed in 1986. It is located on a 5.917 acre site, and is leased until December 31, 2015 to Software AG of North America, Inc. As of the date of value, the subject was used as a multi-tenant building, with three sublease tenants occupying 33% of the building and the lessee occupying 32% of the building. The remaining 35% was unoccupied as of the date of value.

Petitioner presented the following indicators of value:

Market:	$6,868,800.00
Cost:	Not applied
Income:	$6,448,944.00

Based on the market approach, Petitioner presented an indicated value of $6,868,800.00 for the subject property.

Petitioner presented three comparable sales ranging in sales price from $72.93 to $105.81 per square foot and in size from 132,790 to 172,000 square feet. After adjustments were made, the sales ranged from $75.12 to $87.83 per square foot. Petitioner's witness testified that he selected sales that were most similar in age to the subject. Petitioner concluded to a value of $80.00 per square foot for the subject.

Petitioner presented an income approach to derive a value of $6,448,944.00 for the subject property.

Petitioner presented five lease comparables including the sublease agreements within the subject that were signed during the base period. They indicated a range in rental rates of $15.00 to $18.75 per square foot for buildings that were completed between 1982 and 2000. The three subject subleases indicated a range in rental rates of $15.25 to $17.00 per square foot. All lease rates were negotiated on a gross or full service basis, with the landlord responsible for expenses. Petitioner concluded to a rental rate of $17.00 per square foot for the subject. Petitioner deducted vacancy of 10%, management fee of 5% and operating, maintenance and reserves of 10%. Expenses exclusive of property tax were estimated at $5.00 per square foot. Petitioner applied a tax loaded capitalization rate of 10.76%, based on a market derived capitalization rate of 8.0% plus an additional 2.76% for property taxes.

Petitioner is requesting an actual value of $6,500,000.00 for the subject property for tax years 2007 and 2008.

Respondent presented the following indicators of value:

Market:	$13,091,000.00	
Cost:	Not applied	
Income:	$13,250,000.00	to
	$13,540,000.00	

Based on the market approach, Respondent presented an indicated value of $13,091,000.00 for the subject property. Respondent presented information regarding the sale of the subject at a purchase price of $14,600,000.00 on January 23, 2007. Respondent contends that the Board can consider this sale because the subject was under contract in 2005 for $15,840,000.00. Respondent presented conflicting information that identified different parties between a partial copy of the contract and the final deed. Additionally, the sales price varied between the contract price and final deed, with no documentation or testimony presented to support the $1,240,000.00 difference. The Board concludes that the actual sale of the subject was outside the base period and that without conclusive evidence of a contract in place within the base period for the same amount as deeded, the sale cannot be considered.

Respondent presented five comparable sales with time adjusted sales prices ranging from $109.00 to $157.00 per square foot and in size from 11,173 to 196,390 square feet. After adjustments were made, the sales ranged from $139.00 to $157.00 per square foot. Respondent's witness testified that he selected sales that were most similar in location to the subject, with all sales located in Douglas County.

Respondent used the income approach to derive a range in value of $13,250,000.00 to $13,540,000.00 for the subject property. Respondent valued the subject under two separate scenarios. First, Respondent valued the leased fee interest in the subject based on the lease to Software AG at a rental rate of $12.73 per square foot net of expenses. Respondent allowed for no vacancy and deducted expenses of 2% for management fee and 1% for reserves for replacement. A capitalization rate of 8% was applied, resulting in an indicated value of $13,250,000.00, rounded.

In a second analysis, Respondent applied a rental rate of $14.00 per square foot net of expenses based on four comparable properties that were constructed between 1997 and 2001. A vacancy rate of 5% was applied, along with a deduction of 3% for management fee and 2% for reserves for replacement. A capitalization rate of 8.0% was used, resulting in an indicated value of $13,540,000.00 based on the fee simple income analysis. Respondent contends that with just under 10 years remaining on the lease, the *Assessor's Reference Library* (ARL), volume 3, section regarding Long-Term Non-Market Lease Valuation, can be applied in the valuation of the subject.

Respondent assigned an actual value of $12,376,722.00 to the subject property for tax years 2007 and 2008.

The Board concludes that the valuation of the subject property was incorrect for tax years 2007 and 2008. The Board concludes that under *City and County of Denver v. Board of Assessment Appeals and Regis Jesuit Holding, Inc.*, 848 P.2d 355 (Colo. 1993) both actual and market rent can be considered in determining the value for ad valorem tax purposes of real property subject to an existing long-term lease. Petitioner contends that with a remaining lease term of less than10 years as of the date of value, the actual lease rate cannot be considered. Respondent contends that a remaining term of over nine years is relevant. As the *Regis Jesuit* case does not define "long term," we defer to ARL, volume 3, page 7.20 which defines a long term lease as "*Generally a lease agreement extending for 10 years or more*." The Board concludes that the actual lease should be considered in the case of the subject, but that Respondent did not correctly apply the income approach in their valuation of the subject.

Petitioner concluded to a market rent of $17.00 per square foot based on the subject's sublease agreements, which were entered into during a slightly extended base period. Respondent's witness testified that sublease agreements could not be considered as they were below market; however, this testimony was not supported with market data. Petitioner provided support that the sublease rental rates were indicative of market based on direct lease agreements. Respondent's conclusion of market rent at $14.00 per square foot net of expenses is based on comparable rental properties completed between 1997 and 2001, compared to the subject, which was completed in 1986. Despite the high quality and good condition of the subject, Respondent's comparable rentals are not believed to be comparable to the subject due to age.

The Board finds Petitioner's use of a $17.00 per square foot full service (gross) rental rate to be indicative of market rent. As the subject is currently leased on a net basis, we deduct expenses (inclusive of taxes) of $8.10 per square foot based on Petitioner's comparable rental information which indicates expenses ranging from $7.90 to $8.25 per square foot. This results in a net market rent equal to $8.90 per square foot for the subject. Therefore, the current lease to Software AG at $12.73 per square foot net of expenses represented an above market lease as of the date of value. Consequently, the value of the subject property should reflect the above average risk relative to the excess rent. It is unclear from the ARL section on Long-Term Non-Market Lease Valuation what the recommended procedure would be for excess rent, as is the case for the subject. Therefore the Board gives consideration to two income approach analyses.

First the Board calculates the value of the subject using market rent of $8.90 per square foot net of expenses, a 10% market indicated vacancy, a deduction of 3% for reserves and non-reimbursed owner expenses, and a capitalization rate of 8.0%. To this amount, we have added the discounted present value of the excess rent. Excess rent is equal to $3.83 per square foot or $328,844.00 on an annual basis. The present worth of the excess rent is calculated based on 9 years remaining on the lease and a 15% discount rate, using a factor of 4.77. The discount rate is based on the *Smith & Burbach Summer 2006 Real Estate Investment Survey*, which was referenced by both parties. A discount rate at the upper end of the range is a reasonable way to recognize the above average risk associated with excess rent. The resulting indicated value is $9,907,000.00, rounded. This is equal to a value of approximately $115.00 per rentable square foot.

The Board also gives consideration to an analysis utilizing the actual rental rate for the subject at $12.73 per square foot, 10% vacancy and collection loss, and 3% for expenses. The Board capitalizes the net income of $954,187.00 at a rate of 9.25%. The capitalization rate is based on the *Smith & Burbach Summer 2006 Real Estate Investment Survey*. To reflect the higher risk associated with an above market lease, the Board concludes to a rate at the upper end of the range. The value indicated by this analysis is $10,315,536.00, or approximately $120.00 per rentable square foot.

Giving consideration to both methodologies, the Board concludes to a value of $10,110,000.00 for the subject, equal to approximately $118.00 per rentable square foot.

<u>ORDER:</u>

Respondent is ordered to reduce the 2007 and 2008 actual value of the subject property to $10,110,000.00.

The Douglas County Assessor is directed to change his/her records accordingly.

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-five 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-five 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 25th day of November 2009.

BOARD OF ASSESSMENT APPEALS

Louesa Maricle

Debra A. Baumbach

Sondra W. Mercier

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

Heather Flannery

STATE OF COLORADO SEAL BOARD OF ASSESSMENT APPEALS

50112 & 50781