

BEFORE THE NEBRASKA TAX EQUALIZATION AND REVIEW COMMISSION

JBM, Inc.,
Appellant,

v.

Otoe County Board of Equalization,
Appellee.

Case No: 11C 239

Order Reversing the Determination of the
Otoe County Board of Equalization

For the Appellant:
Mukesh M. Patel,
Pro Se

For the Appellee:
David J. Partsch,
Otoe County Attorney

Heard before Commissioners Robert W. Hotz and Nancy J. Salmon.

I. THE SUBJECT PROPERTY

The Subject Property is a commercial parcel located in Otoe County, Nebraska. The parcel is improved with a 74 room hotel. The legal description of the parcel is found at Exhibit 1:1. The property record card for the Subject Property is found at Exhibit 2.

II. PROCEDURAL HISTORY

The Otoe County Assessor (Assessor) determined that the assessed value of the Subject Property was \$1,085,390 for tax year 2011. JBM, Inc. (JBM) protested this assessment to the Otoe County Board of Equalization (the County Board) and requested an assessed valuation of \$693,000. The County Board determined that the assessed value for tax year 2011 was \$1,085,390.¹

JBM appealed the decision of the County Board to the Tax Equalization and Review Commission (Commission). Prior to the hearing, the parties exchanged exhibits and submitted a Pre-Hearing Conference Report, as ordered by the Commission. In the Pre-Hearing Conference Report, the parties stipulated to the receipt of exchanged exhibits.² The Commission held a hearing on March 22, 2012.

¹ Exhibit 1:1.

² JBM offered no exhibits.

III. STANDARD OF REVIEW

The Commission's review of the determination by a County Board of Equalization is de novo.³ When the Commission considers an appeal of a decision of a county board of equalization, a presumption exists that the "board of equalization has faithfully performed its official duties in making an assessment and has acted upon sufficient competent evidence to justify its action."⁴

That presumption remains until there is competent evidence to the contrary presented, and the presumption disappears when there is competent evidence adduced on appeal to the contrary. From that point forward, the reasonableness of the valuation fixed by the board of equalization becomes one of fact based upon all the evidence presented. The burden of showing such valuation to be unreasonable rests upon the taxpayer on appeal from the action of the board.⁵

The order, decision, determination or action appealed from shall be affirmed unless evidence is adduced establishing that the order, decision, determination, or action was unreasonable or arbitrary.⁶ Proof that the order, decision, determination, or action was unreasonable or arbitrary must be made by clear and convincing evidence.⁷

A Taxpayer must introduce competent evidence of actual value of the subject property in order to successfully claim that the subject property is overvalued.⁸ The County Board need not put on any evidence to support its valuation of the property at issue unless the taxpayer establishes the Board's valuation was unreasonable or arbitrary.⁹

In an appeal, the Commission "may determine any question raised in the proceeding upon which an order, decision, determination, or action appealed from is based. The Commission may consider all questions necessary to determine taxable value of property as it hears an appeal or

³ See, Neb. Rev. Stat. §77-5016(8) (2010 Cum. Supp.), *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 286, 753 N.W.2d 802, 813 (2008). "When an appeal is conducted as a 'trial de novo,' as opposed to a 'trial de novo on the record,' it means literally a new hearing and not merely new findings of fact based upon a previous record. A trial de novo is conducted as though the earlier trial had not been held in the first place, and evidence is taken anew as such evidence is available at the time of the trial on appeal." *Koch v. Cedar Cty. Freeholder Bd.*, 276 Neb. 1009, 1019 (2009).

⁴ *Brenner v. Banner Cty. Bd. Of Equal.*, 276 Neb. 275, 283, 753 N.W.2d 802, 811 (2008) (Citations omitted).

⁵ *Id.*

⁶ Neb. Rev. Stat. §77-5016(8) (2010 Cum. Supp.).

⁷ *Omaha Country Club v. Douglas Cty. Bd. of Equal.*, 11 Neb. App. 171, 645 N.W.2d 821 (2002).

⁸ Cf. *Josten-Wilbert Vault Co. v. Board of Equalization for Buffalo County*, 179 Neb. 415, 138 N.W.2d 641 (1965) (determination of actual value); *Lincoln Tel. and Tel. Co. v. County Bd. Of Equalization of York County*, 209 Neb. 465, 308 N.W.2d 515 (1981)(determination of equalized taxable value).

⁹ *Bottorf v. Clay County Bd. of Equalization*, 7 Neb.App. 162, 580 N.W.2d 561 (1998).

cross appeal.”¹⁰ The Commission may also “take notice of judicially cognizable facts and in addition may take notice of general, technical, or scientific facts within its specialized knowledge...,” and may “utilize its experience, technical competence, and specialized knowledge in the evaluation of the evidence presented to it.”¹¹

IV. VALUATION

A. Law

Under Nebraska law,

[a]ctual value is the most probable price expressed in terms of money that a property will bring if exposed for sale in the open market, or in an arm’s length transaction, between a willing buyer and a willing seller, both of whom are knowledgeable concerning all the uses to which the real property is adapted and for which the real property is capable of being used. In analyzing the uses and restrictions applicable to real property the analysis shall include a full description of the physical characteristics of the real property and an identification of the property rights valued.¹²

“Actual value may be determined using professionally accepted mass appraisal methods, including, but not limited to, the (1) sales comparison approach using the guidelines in section 77-1371, (2) income approach, and (3) cost approach.”¹³ “Actual value, market value, and fair market value mean exactly the same thing.”¹⁴ Taxable value is the percentage of actual value subject to taxation as directed by section 77-201 of Nebraska Statutes and has the same meaning as assessed value.¹⁵ All real property in Nebraska subject to taxation shall be assessed as of January 1.¹⁶ All taxable real property, with the exception of agricultural land and horticultural land, shall be valued at actual value for purposes of taxation.¹⁷

An arm’s length transaction is a “transaction between unrelated parties under no duress.”¹⁸

Evidence of sale price alone may not be sufficient to overcome the presumption that the board of equalization has valued the property correctly. But where ... the evidence discloses the circumstances surrounding the sale and shows that it was an arm's length transaction

¹⁰ Neb. Rev. Stat. §77-5016(8) (2011 Supp.).

¹¹ Neb. Rev. Stat. §77-5016(6) (2011 Supp.).

¹² Neb. Rev. Stat. §77-112 (Reissue 2009).

¹³ *Id.*

¹⁴ *Omaha Country Club v. Douglas County Board of Equalization, et al.*, 11 Neb.App. 171, 180, 645 N.W.2d 821, 829 (2002).

¹⁵ Neb. Rev. Stat. §77-131 (Reissue 2009).

¹⁶ See, Neb. Rev. Stat. §77-1301(1) (Reissue 2009).

¹⁷ Neb. Rev. Stat. §77-201(1) (Reissue 2009).

¹⁸ *The Dictionary of Real Estate Appraisal*, 4th Ed., Appraisal Institute, (2002) at pg. 18.

between a seller who was not under the compulsion to sell and a buyer who was not compelled to buy, it should receive strong consideration.¹⁹

B. Summary of the Evidence

The Subject Property was built in 1999.²⁰ It was purchased by JBM on November 16, 2010, at a sale price of \$693,750.²¹ The sale occurred less than two months prior to the assessment date of January 1, 2011.

1. Cost Approach

The Assessor used the cost approach to value the Subject Property at \$1,085,390.²² The cost approach includes six steps:

Estimate the land (site) value as if vacant and available for development to its highest and best use; (2) Estimate the total cost new of the improvements as of the appraisal date, including direct costs, indirect costs, and entrepreneurial profit from market analysis; (3) Estimate the total amount of accrued depreciation attributable to physical deterioration, functional obsolescence, and external (economic) obsolescence; (5) Subtract the total amount of accrued depreciation from the total cost new of the primary improvements to arrive at the depreciated cost of improvements; (5) Estimate the total cost new of any accessory improvements and site improvements, then estimate and deduct all accrued depreciation from the total cost new of these improvements; (6) Add site value to the depreciated cost of the primary improvements, accessory improvements, and site improvements, to arrive at a value indication by the cost approach.²³

The contribution to value of the land component was determined by the Assessor to be \$149,790 for 138,521 square feet, or approximately 3.18 acres.²⁴ The contribution to value of the improvements was determined to be \$935,600 for the 74 room hotel and related improvements.²⁵ The Assessor determined the replacement cost new for the improvements to be \$2,059,165 and assigned depreciation deductions of 60% to some, and 75% to others.²⁶ This resulted in a replacement cost new less depreciation of \$935,600.

¹⁹ *Dowd v. Board of Equalization*, 240 Neb. 437, 447, 482 N.W.2d 583, 589 (1992) (quoting *Potts v. Board of Equalization*, 213 Neb. 37, 47-48, 328 N.W.2d 175, 181 (1982)).

²⁰ E2:2-3.

²¹ E2:2.

²² E2:3.

²³ *Property Assessment Valuation, 3rd Ed., International Association of Assessing Officers* (2010), at 230.

²⁴ E2:3.

²⁵ E2:3. This includes a swimming pool, parking areas, and other refinements.

²⁶ E2:3.

Patel asserted that the Subject Property was significantly overbuilt. He testified that occupancy rates for the hotel, as it was being operated as a chain, had been 20% to 25% before JBM purchased the property. Patel asserted that from November, 2010 to the end of 2011, occupancy rates ranged from 10% to 16%. He testified that based upon its location, the hotel should have been built with no more than thirty rooms, instead of 74. This is tantamount to an assertion that the assessment should have made significant deductions for functional obsolescence. Functional obsolescence is “loss in value due to inability of the improvement to perform adequately the function for which it is used, as of the appraisal date.”²⁷ Patel’s opinion was based upon his experience as a hotel manager in Nebraska. He testified that the hotel, at the location of the Subject Property, should have been built with 15 to 30 rooms, and if it had 15 rooms, it would experience a 0% vacancy rate.

The County Board offered the testimony of Ronald Elliot, a Registered Appraiser. Elliot testified he had been under contract to do appraisal work for the Assessor since 1997. He asserted that he had been responsible for the cost approach determinations for the Subject Property for tax year 2011. Elliot said that he followed mass appraisal procedures when preparing the assessment. He testified that he used sales in Nebraska City, the largest city in Otoe County, to determine the physical depreciation deduction for the Subject Property. Elliot asserted that he did a physical inspection of the Subject Property at the time of the sale in November, 2010. He testified that as a result of the inspection, he concluded the Subject Property should be rated as fair condition and fair quality.

Elliot further testified that the 60% depreciation deduction was composed of 40% physical depreciation and an additional 20% depreciation attributable to a curable functional obsolescence that the Subject Property suffered from being overbuilt. He testified that the 40% physical depreciation deduction was based upon an economic life of 35 years and an effective age of 15 years. He explained that the 20% functional depreciation deduction was assigned based upon his subjective determination of the economically reasonable size of the Subject Property. He opined that a hotel at the location of the Subject Property would be overbuilt if it had more than 50 rooms. Elliot testified that 20% for functional depreciation “may not be quite enough,” but he

²⁷ *Property Assessment Valuation*, at 282.

expressed concerns that if the value of the property were adjusted further it would no longer be equalized with similar properties in the county.

Based upon its review of the evidence, the Commission finds that the number of rooms constructed in the Subject Property is best described as superadequacy. Superadequacy is a form of functional obsolescence and may be either curable or incurable.²⁸ “Incurable functional obsolescence, superadequacy occurs when a property component exceeds what the market requires. It represents a cost without any corresponding increment in value.”²⁹ “Superadequacy is a condition in which the component is more than adequate for its intended function...”³⁰ In this appeal, the parties agreed that the Subject Property was overbuilt by at least 24 rooms.³¹ “In a replacement cost new estimate, theoretically the cost to replicate the superadequacy item is not included in the cost new estimate.”³² Instead of excluding the superadequacy in his cost approach, Elliot included the replacement cost new of the superadequacy, and then made a 20% deduction. Even so, the basis for this deduction was not provided, and Elliot conceded that, “it may not be quite enough.”

There are two tests for determining whether an item of functional obsolescence is curable: (1) “if spending the money to cure the item results in a value increment equal to or greater than the expenditure, the item is normally considered to be curable;”³³ and (2) “if spending the money to cure the item does not result in a value increment equal to or greater than the expenditure but allows the existing items to maintain their value, the item is considered curable.”³⁴ No evidence was offered to prove that the functional obsolescence of the Subject Property is curable, as opined by Elliot. The Commission finds that the overbuilt hotel rooms of the Subject Property are an incurable functional obsolescence superadequacy.

Generally, when using the cost approach, there is no need to estimate the value of the incurable functional obsolescence superadequacy.³⁵ A determination of the replacement cost

²⁸ *Id.* at 287.

²⁹ *Id.* at 289.

³⁰ *Id.* at 287.

³¹ Elliot testified that the hotel would not be overbuilt if it contained as many as 50 rooms. Patel asserted that the hotel would be overbuilt if it had contained as few as 30 rooms.

³² *Property Assessment Valuation*, at 287.

³³ *Id.* at 288.

³⁴ *Id.*

³⁵ *Id.*

new estimates the cost to construct the improvement as it would be built today, without the superadequacy; the amount of actual value attributable to the superadequacy is set at \$0 on the front end, since costs associated with the construction of incurable functional obsolescence superadequacy do not result in a corresponding increment in value. However, where an item of incurable functional obsolescence superadequacy is not removed before calculating the replacement cost through other means, the assessor must quantify an estimate of the superadequacy and value it at \$0 at the front end.³⁶ Further, any extraordinary expenses of ownership associated with the item of incurable functional obsolescence superadequacy must be quantified and subtracted from the cost new estimate.³⁷

The Commission finds that while the Assessor attempted to quantify the incurable functional obsolescence superadequacy, it inappropriately assigned a percentage deduction for the superadequacy after determining the replacement cost new estimate of the superadequacy, instead of setting the initial value at \$0. The Commission emphasizes that typically it is not necessary to quantify the value of an incurable functional obsolescence superadequacy when using the cost approach to determine value because the replacement cost new typically eliminates the superadequacy when the cost new estimate is produced.³⁸ However, in these more rare instances where the cost approach does not eliminate the incurable functional obsolescence superadequacy by process, the assessor must quantify the superadequacy and set the value at \$0 on the front end. Therefore, the Commission finds that the County Board's reliance upon the cost approach as developed by Elliot was unreasonable.

2. Sale Price

Mukesh Patel testified on behalf of JBM in his role as President of JBM. Patel asserted that the sale price of \$693,750 on November 16, 2010, was the best evidence of actual value of the Subject Property as of January 1, 2011. In addition to the real estate, JBM also purchased from the same seller personal property for an additional \$81,000.³⁹ Patel testified that the seller had hired a hotel brokerage company to sell the Subject Property. He asserted that the property had

³⁶ *Id.* at 289-290.

³⁷ *Id.*

³⁸ See Generally, *Id.* at 290 (discussing how extra ceiling height in a residential home, while incurable functional obsolescence superadequacy need not be quantified).

³⁹ E21:1.

been listed for sale on the internet for 16 months prior to the sale, and that during the same time period a sale billboard had been posted on the property, where Highway 50 and Highway 2 intersect. Patel testified that JBM and the seller participated in extensive negotiation for 5 to 6 months before reaching an agreement. He stated his belief that JBM was the high bidder at \$693,750 in an arm's length transaction.

Elliot testified that the sale of the Subject Property in November, 2010 was "somewhat distressed," but he said that in his opinion it was an arm's length sale. He said that the circumstances related to the sale had been analyzed and that the sale would be deemed to be a qualified sale in the Assessor's sales file as an arm's length transaction for inclusion in the Assessor's land sale model beginning in tax year 2012.⁴⁰

The strength of a sale price as indicia of the actual value of a property is dependent upon factors including, but not limited to, the amount of time between the sale and assessment, and whether the sale was arm's length; these factors must be considered when determining the strength of the sale price.⁴¹ "Sale price is not synonymous with actual value or fair market value."⁴² However, the Nebraska Supreme Court has reasoned:

Evidence of sale price alone may not be sufficient to overcome the presumption that the board of equalization has valued the property correctly. But where, ... the evidence discloses the circumstances surrounding the sale and shows that it was an arm's length transaction between a seller who was not under the compulsion to sell and a buyer who was not compelled to buy, it should receive strong consideration.⁴³

An arm's length transaction is "a transaction between unrelated parties under no duress."⁴⁴ Elliot testified that despite the fact that the sale was "somewhat distressed," it was deemed by the Assessor to be an arm's length transaction. The Taxpayer's testimony indicates that the sale was arm's length, without duress, and between unrelated parties.⁴⁵ Further, contrary to the usual concerns associated with non-arm's length transactions, the Subject Property was listed on the

⁴⁰ Elliot's opinions regarding the sale being distressed, and the Assessor's use of the sale as a qualified sale appear to be disharmonious. The County Board offers Elliot's opinion regarding distress on the one hand to prevent using the sale price as evidence of actual value, but the County Assessor on the other hand has qualified the same sale so that the sale price is included in the array of sales to indicate the actual value of other comparable properties in Otoe County.

⁴¹ *Forney v. Box Butte County Bd. of Equalization*, 7 Neb.App. 417, 424, 582 N.W.2d 631, 637, (1998).

⁴² *Id.*

⁴³ *Dowd v. Board of Equalization*, 240 Neb. 437, 447, 482 N.W.2d 583, 589 (1992) (quoting *Potts v. Board of Equalization*, 213 Neb. 37, 47-48, 328 N.W.2d 175, 181 (1982)).

⁴⁴ *The Dictionary of Real Estate Appraisal*, 4th Ed., Appraisal Institute, (2002) at pg. 18.

⁴⁵ See, *The Dictionary of Real Estate Appraisal*, 4th Ed., Appraisal Institute, (2002) at pg. 18.

open market for 16 months, and the parties underwent extensive negotiations before settling on the sales price. These factors indicate that the sale was made with “the objective of maximizing the financial position of the parties involved.”⁴⁶ Elliot’s testimony, which was the only evidence of distress relating to the sale, also included his opinion that the circumstances surrounding the sale were sufficient to qualify the sale as an arm’s length sale for purposes of the Assessor’s sales roster, and that the sale had been qualified and included in the sales roster at the relevant time. Further, the sale was very close in time to the date of assessment (less than two months).

The Commission finds that the sale of the Subject Property in 2010 was arm’s length, and as such should receive strong consideration. Other than the Assessor’s original assessment and the sale price of the Subject Property, no other opinion of the actual value of the Subject Property was presented by either party. The Commission finds under these facts that the sale price of the subject property is clear and convincing evidence of the actual value of the Subject Property.

V. CONCLUSION

The Commission finds there is competent evidence to rebut the presumption that the County Board faithfully performed its duties and had sufficient competent evidence to make its determination. The Commission also finds that there is clear and convincing evidence that the County Board’s decision was arbitrary or unreasonable.

For all of the reasons set forth above, the decision of the County Board is vacated and reversed.

VI. ORDER

IT IS ORDERED THAT:

1. The decision of the Otoe County Board of Equalization determining the value of the Subject Property for tax year 2011 is vacated and reversed.⁴⁷

⁴⁶ *Mass Appraisal of Real Property*, International Association of Assessing Officers, (1999) at 53-54 (discussing the reliability of sales).

⁴⁷ Assessed value, as determined by the County Board, was based upon the evidence at the time of the Protest proceeding. At the appeal hearing before the Commission, both parties were permitted to submit evidence that may not have been considered by the county board of equalization at the protest proceeding.

2. The actual value of the Subject Property for tax year 2011 is:

Total	\$693,750.00
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3. This decision and order, if no appeal is timely filed, shall be certified to the Otoe County Treasurer and the Otoe County Assessor, pursuant to Neb. Rev. Stat. §77-5018 (2011 Supp.)
4. Any request for relief, by any party, which is not specifically provided for by this order is denied.
5. Each party is to bear its own costs in this proceeding.
6. This decision shall only be applicable to tax year 2011.
7. This order is effective for purposes of appeal on September 19, 2012

Signed and Sealed: September 19, 2012

Robert W. Hotz, Commissioner

SEAL

Nancy J. Salmon, Commissioner

Appeals from any decision of the Commission must satisfy the requirements of Neb. Rev. Stat. §77-5019 (2011 Supp.), other provisions of Nebraska Statute and Court Rules.