FINAL ADMINISTRATIVE DECISION
ILLINOIS PROPERTY TAX APPEAL BOARD

APPELLANT: Northwoods Healthcare Center
DOCKET NO.: 04-01537.001-C-3
PARCEL NO.: 07-01-151-003

The parties of record before the Property Tax Appeal Board are Northwoods Healthcare Center, the appellant, by attorneys Allen A. Lefkovitz and Frederick F. Richards, III of Allen A. Lefkovitz & Assoc. P.C. of Chicago; and the Boone County Board of Review by attorneys Gregory J. Lafakis and Ellen G. Berkshire of Verros, Lafakis and Berkshire, P.C. in Chicago.

Based on the facts and exhibits presented, the Property Tax Appeal Board hereby finds ***an increase*** in the assessment of the property as established by the **Boone** County Board of Review is warranted. The correct assessed valuation of the property is:

LAND:	$ 167,400
IMPR.:	$ 1,238,760
TOTAL:	$ 1,406,160

Subject only to the State multiplier as applicable.

ANALYSIS

Pursuant to Property Tax Appeal Board rule 1910.78 (86 Ill. Adm. Code 1910.78), Docket No. 04-01537.001-C-3 was consolidated with Docket No. 05-00974.001-C-3 for purposes of oral hearing. Decisions for assessment years 2004 and 2005 will be issued separately.

The subject property is improved with a two-story, brick and masonry constructed skilled care nursing home facility containing 116 beds. The building contains a gross-building area above grade of approximately 28,700 square feet with approximately 10,726 square feet of partially finished basement area. The building was constructed in 1972. The partially sprinklered improvement is located on a parcel containing 126,324 square feet. In addition to the nursing home, the subject site is improved with a 1,250 square foot frame garage. The property is located in Belvidere, Flora Township, Boone County.

The appellant, through counsel, appeared before the Property Tax Appeal Board contending overvaluation as the basis of the appeal. In support of its claim, the appellant offered an appraisal ("REAC Report") which estimated a value of $2,300,000 as of January 1, 2003. Appraiser, John VanSanten, was present at the hearing and provided oral testimony detailing the appraisal methodology and final value conclusion.

The appellant called as its first witness John VanSanten, who is currently employed by Wellspring Partners as a director and real estate practice leader; this company's sole focus is on health care related properties. VanSanten was previously employed by Real Estate Analysis Corporation (REAC), and was one of the preparers of the appellant's appraisal report. VanSanten had been employed with REAC for approximately four years where he was vice president. VanSanten is licensed by the State of Illinois as a Certified General Appraiser and holds an Member of the Appraisal Institute ("MAI") designation from the Appraisal Institute since 1999. Without objection, VanSanten was accepted as an expert. He testified that the subject, Northwoods Care Center, is a 116 bed licensed skilled nursing facility. The subject was issued a Certificate of Need from the Illinois Health Facilities Planning Board. The date of issuance was not disclosed, however, the record disclosed that the license capacity of the facility was reduced from 120 Skilled Nursing Facility ("SNF") beds to 116 SNF beds on January 1, 2003. A Certificate of Need is required in order to operate a nursing home in Illinois. In addition, the subject is licensed by the Illinois Department of Public Aid for skilled nursing beds.

The subject property was inspected on May 28, 2004. The REAC appraisal valued the subject using the three traditional approaches to value in estimating the subject's market value for real estate only, excluding the business value and personal property. VanSanten along with other members of the REAC firm prepared the REAC Report.

VanSanten testified that a nursing home is known in the valuation industry as a going concern. It is an operating business that is real estate intensive. Within a going concern of a nursing home you have the land, building and personal property; which would be the equipment used to operate the nursing home, like beds and kitchen equipment. In addition, there is also intangible value which is associated with operating the business within the nursing home. Examples of intangible assets would include the Certificate of Need, the highly specialized and trained skilled work force, the goodwill associated with the name of a nursing home and its reputation.

VanSanten stated that the subject is a special use property because it is a building that was specifically designed to provide nursing care services. It is extremely difficult and cost prohibitive to convert the subject to alternative uses. VanSanten used all three approaches to value in estimating the market value of the subject property. Even though the property was built in 1972, he relied primarily on the cost approach to value. VanSanten stated that in the valuation of the real estate component of a nursing home, the most appropriate approach to place emphasis on is the cost approach because a nursing home is a going concern, which is made up of different asset types, including intangible business value. An income approach looks at the cash flow from operations with the resulting value including more than just the land and building. Further, when the sales comparison approach is used, it includes nursing home sales where the buyer is not buying just the land and building, they are buying the ongoing concern, which would include the assembled work force, the Certificate of Need, the license, and any goodwill that is associated with that nursing home. Thus, the sales price reflects more than just the land and building. When using the sales approach or income approach to value for real estate tax purposes, adjustments are made to account for the business value. The cost approach does not have a business value included, which is why it is the most reliable approach to use for real estate assessment purposes.

The first step under the cost approach was to estimate the land value utilizing seven comparable vacant land sales located in Belvidere. The comparables ranged in size from 8,400 to 130,680 square feet. The comparables sold from September 2002 to October 2003 for prices ranging from $0.62 to $5.12 per square foot of land area. Adjustments were made to the land sales for size, zoning and location. After making the adjustments, the appraiser estimated the subject's per square foot land value was between sale number six (the highest of the inferior land sales), and sale number seven (the only superior land sale) for a range between $3.00 and $5.12 per square foot of land area. Based on these adjusted sale prices, the appraiser concluded a market value of $4.00 per square foot for the subject land or $500,000, rounded[1].

The appraiser estimated the replacement cost new of the subject improvements using the R.S. Means Cost Manual. At the hearing, VanSanten testified that he was revising his opinion of value for the subject based on the cost approach from $2,215,000 to $2,100,000 because of errors he noticed in the cost approach analysis contained within the REAC appraisal report[2]. Under the "General Conditions" column, the adjustment should actually read

[1] During the hearing, both parties stipulated that the fair market value of the subject's land for the 2004 and 2005 assessment years was $500,000.
[2] See pages 82 and 83 of the REAC Appraisal.

25% instead of 15%. This includes such things as the developer's overhead, developer's profit and most of the soft costs that go into construction. In addition, the location factor of 1.05 was incorrectly applied and required correction. The revised total cost new was $4,793,622 or $121.59 per square foot of building area. Based on the error corrections, VanSanten prepared a revised cost spreadsheet[3]. VanSanten estimated physical depreciation using the age/life method. VanSanten stated that the appraisers (REAC) used their own opinion of what they thought the economic life would be. They estimated the effective age of the subject was equal to its actual age or 30 years old. The appraisers further found the subject's total economic life to be 50 years. The appraisal depicts physical depreciation of 60% based on a standard age/life method (effective age divided by the total economic life of 50 years). The appraisal depicted a total replacement cost new of $4,286,873 less physical depreciation of $2,572,124 for a total depreciated value of the improvements of $1,714,749. A land value of $500,000 was added to this to estimate a value for the subject of $2,215,000, rounded. As stated previously, this estimated cost approach value was revised to $2,100,000. Over objection, appellant's counsel attempted to introduce a life expectancy guideline from Marshall Valuation Service as appellant's exhibit "C." Based on this document, VanSanten amended his opinion of the subject's total economic life to be 45 years as opposed to 50. He stated 45 years would be appropriate for good or average property[4]. He testified that in addition to using the Marshall Valuation Service guideline, his opinion is also based on his knowledge and expertise in appraising other various nursing homes.

Under the income capitalization approach, VanSanten examined the historical income and expenses for the subject property for years 2000 through 2002 (see Exhibit A, p. 92 of REAC Report). He also analyzed the payor mix for the property and found the majority of the occupancy, over 69% of the total patient days, consisted of Medicaid patients (REAC Report, p. 93). VanSanten stated that the Medicaid rate for nursing homes consists of three components: nursing care, support services and capital cost. VanSanten stated that it is the intention of the State through the

[3] Based on objection by the board of review, the revised cost spreadsheet, marked as Appellant's Exhibit "B" was not considered in the Board's analysis because it was untimely filed. The document was allowed into the record for administrative appeal purposes under an offer of proof. (See Transcript page 37-38).

[4] Based on objection by the board of review, the Marshall Valuation Service Life Expectancy Guidelines, marked as Appellant's Exhibit "C" and a revised Cost Approach Conclusion, marked as Appellant's Exhibit "D" were not considered in the Board's analysis because the documents were untimely filed. The documents were allowed into the record for administrative appeal purposes under an offer of proof. (See Transcript pages 49-50).

reimbursement rate to reimburse on the three components to provide a nominal rate of return. The capital cost component is intended to provide a return to the real estate associated with the building and is a market derived return. The first factor was to determine revenue which was derived from looking at what the average rate per patient day would be as well as the occupancy rate for the nursing home (REAC Report, p. 95). They estimated the average daily rate to be $135 per day. This average daily rate was multiplied by the 116 beds and again multiplied by a 94% occupancy rate to estimate a total annual room and board revenue of $5,373,000, rounded.

Next, expenses such as nursing, housekeeping, dietary, employee welfare, laundry/linen, management fees, general administrator fees and insurance were analyzed using historical operating statements to estimate total operating expenses of $3,894,000. The expenses, along with the return of personal property in the amount of $93,000 were deducted from total gross revenue to estimate a stabilized net income for the subject of $1,386,000 (REAC Report, p. 101).

The next step under the income approach analysis was the determination of an appropriate capitalization rate. The appraisal (REAC Report, p. 105) depicts five sales of nursing homes that were utilized and the estimated overall capitalization rates for each nursing home sale. The overall capitalization rates ranged from 10.7% to 12.8%. The appraisers also considered investor surveys to derive the appropriate capitalization rate for a nursing home. Utilizing the band of investment technique, the appropriate lending terms and equity, VanSanten opined a 13% overall capitalization rate was appropriate (REAC Report, p. 106). Net income of $1,386,000 was divided by a total capitalization rate of 13.7% (capitalization rate of 13% plus an adjusted effective tax rate of 0.7%) to estimate a value for the subject using the income approach of $10,115,000, rounded. A business enterprise value of $7,800,000 was deducted to arrive at a value for the subject real estate of $2,315,000 (REAC Report, p. 108).

VanSanten stated that business enterprise value is synonymous with intangible value. As previously stated, this would include any licenses, management expertise, brand names and trademarks. The appraisers considered four different methods to quantify the intangible value for the subject. They first compared the cost approach conclusion to the income capitalization approach conclusion. The difference between the two approaches to value would be attributable to intangible assets since the cost approach does not include an intangible business component. Using his revised cost approach value of $2,100,000 compared to the income approach value of $10,115,000, depicts an intangible value for the subject of $8,015,000. The appraisers next considered the capital cost component for Medicaid reimbursement to estimate intangible value. VanSanten testified that approximately 12% of the Medicaid reimbursement rate is attributed to the capital cost component, which includes the State's calculation of return on the land and building of $10.16 per day. After deducting out amounts for equipment, working capital and payment of real estate taxes, $5.96 per patient day for return on the land and the buildings comes straight from the Illinois Department of Public Aid. Using the capital cost component and the estimated occupancy rate of 94% translates into net income attributed to the real estate. Multiplying this amount by 116 beds and the occupancy rate depicts an annual net income attributed to the real estate of $237,205. Capitalizing this amount by a 10% real estate capitalization rate depicts a value for the subject's real estate component of $2,370,000. The third method (HUD loan underwriting guidelines) and the fourth method (arm's length leases of nursing homes) were not given much weight, but were considered on pages 115-116 of the REAC Report. VanSanten opined that method one (the difference between the cost approach value and the income approach value) is the most reliable method to estimate intangible value. For this reason, he estimated the subject had an intangible asset value of $7,900,000.

VanSanten next considered the sales comparison approach to value. He again stated that the recorded sales prices reflect the land and building value, along with personal property and any intangible value associated with the business operation. VanSanten further testified that the value of the intangibles and the tangible personal property is not reflected in the real estate transfer declaration sheets. Typically, the recorded sales price reflects the value of the real estate without a breakdown. The appraisers utilized five sales. Adjustments were made for various characteristics such as location, age, land to building ratios, net income per bed, occupancy rates and number of beds, with the primary emphasis placed on the net income per bed that was being generated by the sales comparables. On page 137 of the REAC Report, a graph depicts a unit range of between $1,663 to $6,665 net income per bed. The subject is depicted as having a net income per bed of $11,350. The graph also depicts a sales price per bed ranging from $15,569 to $52,587. The two highest per bed values were described as superior to the subject with the remaining comparable sales being considered inferior to the subject. The REAC Report depicts a per bed unit value of $90,000 which best represents the market value of the going concern (REAC Report, p. 137). VanSanten testified that this translates into a market value of total assets for the subject of $10,440,000. VanSanten then deducted the $7,900,000 intangible asset value derived earlier and the depreciated value of personal property ($290,000) to estimate a value for the subject's real estate component under the sales comparison approach of $2,250,000[5].

VanSanten further testified that based on the corrected values for each of the three approaches, it was his opinion that the value for the subject property real estate, only, was $2,150,000[6].

During cross-examination, VanSanten admitted that David Schoenike inspected the subject property in preparation of the REAC appraisal report. VanSanten further admitted that he did not inspect the property until the day before the hearing. It was Schoenike that drafted the appraisal report. Schoenike would have researched some of the comparable sales and put together the cost chart which contained errors. VanSanten reviewed the REAC Report. Michael Kelly and William Townsley signed off on the report as a matter of course. Even though it is a requirement under the Uniform Standards of Professional Appraisal Practice ("USPAP") to specifically state the intended users of the report, it was not included in the REAC Report. During his testimony, VanSanten stated the subject was considered a special use property, however, this issue was not addressed in the REAC Report. VanSanten agreed that he placed the most reliance on the cost approach because he considered the subject to be a special use property. When he signed the REAC Report in September 2005, he did not notice the errors. He relied upon Schoenike's estimate of the subject property's condition and on a previous appraisal performed on the subject property in 1999 by his firm. VanSanten admitted that the 1999 appraisal was a case in which the appellant lost the appeal at that time. VanSanten agreed that the calculation of depreciation via the age/life method is an opinion, and that he changed his opinion from 60% depreciation for the subject to 67%.

VanSanten further admitted that the concept of business enterprise value has been widely accepted, however, the method for quantifying business enterprise value is still a matter of debate within the appraisal industry. VanSanten stated that the replacement cost of personal property in the amount of $5,000 per operating bed or $580,000 (REAC Report, p. 84) is not detailed within the report. He considered the $5,000 amount as an industry standard, which is not stated or shown in the report. VanSanten further admitted that the 50% depreciation used for personal property is not supported with market data within the REAC Report. In addition, because of the corrections he made earlier he would also have to change the tax amount of $66,450 on page 108 of the REAC Report, as it would also be incorrect.

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[5] REAC Report, p. 137 depicts a value indicated by the sales comparison approach of $2,350,000.

[6] REAC Report, p. 141 depicts a market value of the real estate portion of the total subject property as of January 1, 2003 of $2,300,000.

VanSanten acknowledged that effective tax rate calculations were actually 2.96% as opposed to the 3.0% depicted in the report on page 107. He admitted that the effective tax rate figure was rounded up and would result in a lower value for the subject when applied in calculation of the overall capitalization rate. VanSanten also admitted that if there was an error in the cost approach, which there was, it would also impact the income approach value conclusion. VanSanten stated that the 10% capitalization rate used for real estate was not specifically supported within the REAC Report. The 10% real estate capitalization rate used was based on research the appraisers did at that time. VanSanten stated that in his comparable sales section of the REAC Report, the sentence which states sales comparables two and four were superior to the subject based on their superior net incomes per bed would be incorrect (REAC Report, p. 137). He admitted that his sales comparison approach also relied upon the value estimate from his income approach in determining business enterprise value. If there were errors in his income approach they would also be carried over to the sales comparison approach. Based on the evidence and testimony presented, the appellant requested a reduction in the subject's assessment commensurate with the revised estimated market value for the subject of $2,100,000[7].

The board of review, through counsel, submitted its "Board of Review Notes on Appeal" wherein its final assessment of the subject totaling $1,066,998 was disclosed. The subject's assessment reflects a market value of approximately $3,186,971 using the 2004 three year median level of assessments for Boone County of 33.48% as determined by the Illinois Department of Revenue. In support of its assessment and the request for an increase in assessment, the board of review offered a narrative appraisal ("McCann Report"), which estimated a value of $4,200,000 as of January 1, 2004. The appraiser, Michael McCann, was present at the hearing and provided oral testimony detailing his appraisal report.

The board of review called as its witness Michael McCann. Mr. McCann is president and general manager of William McCann and Associates; which primarily focuses on appraisals and consulting. He has been a real estate appraiser for 27 years. He is a certified review appraiser with the National Association of Review Appraisers and Mortgage Underwriters. He is also a Certified General Real Estate Appraiser licensed by the State of Illinois. He has appraised in excess of three dozen health care related properties. During preparation of the appraisal, he had assistance from James Foley, who has experience in appraising over 100 nursing home facilities prior to joining McCann's firm.

[7] The board of review moved for a directed verdict based on the evidence and testimony presented. After consideration of the evidence and testimony presented the Property Tax Appeal Board denied the motion.

McCann inspected the subject property in January and May of 2006. He did both an interior and exterior inspection. He appraised the real property only, exclusive of all business going concern or personal property. McCann testified that a business value is really an enterprise value that is separate and apart from the real estate itself. It can be measured by the income that the operation generates as opposed to the income that the real estate generates. He testified that it is well settled that the real estate income is best defined by the rental income that the property itself would generate. His appraisal does not include any business value. McCann further testified that going concern value is really a component of business value from an established operation as opposed to a start up operation. Business value is any enhancement to value that results from that stability or being a proven operation and is an intangible. His opinion of market value for the subject is for real estate only and completely excludes business, going concern and personal property.

In preparation of the appraisal report McCann inspected the subject property, reviewed historical data, prior appraisals and assessment history. He also researched comparable land sales, approved sales and rental data. He researched public records ranging from the Department of Public Health financial and statistical reports as well as lease information for nursing homes throughout Illinois.

McCann defined special use properties as something that is so unique or special that it is not commonly traded in the market, meaning being bought and sold. He stated nursing homes are bought and sold with regularity. The subject is a fairly typical well maintained skilled care nursing facility.

McCann first had to determine the subject's highest and best use for the subject site as if it were vacant. On that basis, under the D2 zoning, some type of residential development would be the highest and best use. As part of a highest and best use analysis for a residentially zoned site, there has to be some support for and basis for concluding that a special use would be granted. McCann found no basis, when looking at the subject site as if vacant, except potentially that there may be a shortage of beds identified in the subject's immediate area.

McCann gave equal weight to all three approaches to value, even though each approach was prepared independently. McCann testified that the three approaches: cost, sales and income, depicted a relatively tight range and were very supportive of each other.

Under the cost approach to value, McCann reviewed the public records of Boone County vacant land sales in the subject's market area. The land sales ranged from $3.00 to $5.00 per square foot, wherein he concluded the market value for the subject's site was $4.00 per square foot of land area or $500.000[8].

McCann next developed a replacement cost analysis as opposed to a reproduction cost analysis. His analysis was based on the Marshall and Swift Valuation Service construction cost indexes with adjustments for local and time multipliers. He considered the subject to be a Class "B" convalescent hospital as found in Section 15 of the Marshall and Swift cost manual. It was considered a good quality facility. He also used a separate cost measurement for the basement space, which has a lower cost than the above-grade space.

The decision to use Class "B" for convalescent hospitals was based on his personal inspection of the subject. Upon questioning, McCann testified that classifying the subject as a Class "B" as opposed to a Class "C" would not make that much difference in the base cost amount. The witness explained the replacement cost analysis does not reproduce the building exactly as constructed. A reproduction cost analysis is a brick by brick comparison and generally is higher than a replacement cost analysis. Replacement cost, as he used, is the replacement cost of a facility of similar utility and quality, and would be a suitable replacement in the market for whatever is being appraised.

McCann estimated the replacement cost new of the improvements to approximate $6,022,121 or $209.83 per square foot of building area, which includes the parking, landscaping and garage. He then estimated the replacement cost new of the subject's basement area of $1,175,033 or $109.55 per square foot of basement area. Adjustments were also made for soft costs and factors not included in the cost manual for real estate taxes and insurance ($30,104) during the construction period and for an entrepreneurial profit margin of 10% or $106,817.

McCann then applied a depreciation analysis based on the good condition of the subject property. McCann stated that even though the subject was built in 1972 it had an indicated effective age of 25 years using the age/life method. The effective age takes into account any functional or external obsolescence. The subject had some functional obsolescence because the rooms are small and the subject has a higher number of multi-bed rooms as supposed to more modern standards of private or semi-private rooms. Using a replacement cost analysis eliminates functional obsolescence, external obsolescence and physical deterioration, unless it is specifically identified as a cost to cure item. With a 50 year expected economic life, a 50% depreciation factor was considered appropriate for the subject improvement. He then added the depreciated replacement cost new

[8] Land market value was stipulated at $500,000. (See Footnote 1).

of the improvements ($3,598,577) to the land value ($500,000) which indicated a value for the subject by the cost approach of $4,100,000, rounded (McCann Report, p. 51).

McCann next developed a sales comparison approach to value. He utilized six sales[9]. The sales comparables, consisting of long-term care facilities, were located in Elmhurst, Barrington, Waukegan, Willowbrook, Woodstock and three in St. Clair County. The sales comparables were situated on sites ranging in size from 1.54 acres to 10.33 acres. The properties ranged from 115 to 210 unit bed facilities and contained from 29,252 to 66,447 square feet of building area. The comparables sold from January 2000 to May 2004 for prices ranging from $3,812,250 to $9,500,000 or from $33,150 to $60,000 per unit bed or from $75.25 to $181.43 per square foot of building area, including land. The subject has 116 unit beds, 2.30 acres of land and 39,426 square feet of building area. McCann testified that the sales comparables represented a good cross section of the market in the metro area, as well as more rural locations. They are fairly comparable in size, age, quality, and services to the subject property. He personally verified the terms and conditions of each sale using the recorded Illinois Real Estate Transfer Declaration sheets. Each sale was verified with the buyer as being an arm's length transaction with the prices reflecting a purchase for real estate only. In contradiction to VanSanten's testimony regarding the lack of reliability of sales price information recorded on a Real Estate Transfer Declaration sheet, McCann noted that the transfer declaration sheet for sale number one depicted a transfer of personal property in the amount of a couple of million dollars. Adjustments were made to each sale for physical characteristics, size, location, frontage, zoning and date of sale. Sales five and six were sold pursuant to purchase options exercised by the existing lessee. McCann took this into account during his analysis of the sales comparables. Based on his analysis of the comparable sales and after making adjustments, it was McCann's opinion that the market value of the subject property indicated by the sales comparison approach ranged from $35,000 to $40,000 per bed. Using $37,500 per unit bed indicated a value for the subject under the sales comparison approach of $4,350,000 (116 beds x $37,500) or $110.33 per square foot of building area, including land.

The final approach developed by McCann was the income approach to value. To estimate market rent, he performed an analysis of all nursing homes in health services located in area 1 in northern Illinois. These were located through the Department of Public Aid statistical and facility reports prepared by the owners. As part of the normal and required reporting procedures, a nursing

[9] Sale number 4 sold simultaneously with 7 other long term care facilities. The sale price is an allocation of the bulk sale. Sale number 5 is a three property transaction.

home must report certain statistics to the State. The market rents, as shown on pages 65-66 of his report indicates annual market rents ranging from $2,249 to $4,924 per unit bed. From this data, McCann estimated an annual market rent for the subject of $4,000 per unit bed or $464,000.

McCann next analyzed four operating years (2000, 2001, 2002 and 2003) of the subject. Applying the estimated market rent ($4,000) on an annual basis to the subject indicated a stabilized net annual rental income of $464,000. A conservative vacancy factor of 5% or $23,200 was deducted based on the historical data of the subject even though the subject showed an increase in occupancy over the prior three-year period, which indicated effective net annual income of $440,800. Deducting management and miscellaneous expenses (3% or $13,224) and reserves for replacements (2% or $8,816) indicated a net annual operating income for the subject of $418,760 (McCann Report, p. 69). McCann further testified that page 68 of his report depicts the subject's actual net income in 2003 as being $1,243,000 which is the subject's total going concern. His estimated annual rent is roughly one-third of that amount and is attributable to the real estate only.

The next step in the income approach was to develop an appropriate overall capitalization rate. He reviewed the sales data where lease information was available for actual sale transactions for leased facilities. The capitalization rates ranged from 9.7% to 10.7%. In addition, he examined published information regarding nursing facilities: National Investment Center for Senior Housing & Care Industry, Senior Care Investor, Levin Associates, Senior Housing Investment Survey and Spring 2004, and Senior Living Valuation Services, Inc. These capitalization rates represent going concern capitalization rates. The average capitalization rates in these studies ranged from 13.1% to 13.6% which are typically higher than real estate returns because of the increased risk. He then examined accepted and published surveys by Price Waterhouse Cooper, LLP and the 2004 Korpacz Real Estate Investor Survey which revealed a range of capitalization rates ranging from 6.8% to 12%. These surveys are commonly used by commercial appraisers. Based on the effective date of the appraisal and the preceding analysis, McCann estimated a capitalization rate for the subject ranged from 9% to 11%. Based on the reliability of the methods of selecting an overall capitalization rate, McCann concluded a 10% capitalization rate for the subject was appropriate. He did not feel there was a need to load the capitalization rate with real estate taxes as might be done in a multi-tenant property. After applying the estimated overall capitalization rate of 10% to the subject's estimated net income attributable to a net lease of the subject property indicated an estimated value for the subject by the income approach of $4,200,000.

In his final reconciliation of value, McCann testified that he gave all three approaches to value equal weight. McCann testified that he formed his conclusions of value for the subject and prepared the appraisal in accordance with the provisions of USPAP. His final opinion of value for the subject was $4,200,000 as of January 1, 2004. Based on this evidence, the board of review requested the subject's assessment be increased commensurate with the estimate of value contained within the McCann Report.

During cross-examination, McCann stated that pages 65 and 66 of his report depict that 9 out of his 11 market leases were between related parties. Counsel questioned McCann regarding his opinion that the subject property depicted an effective age of 25 years old even though its actual age was 32 years old. McCann stated that a person walking into the subject building without knowing its age, it would appear to be 25 years old. Even with good maintenance and updated decorating, it has an overall appearance of functional utility or lack of utility that reflects 25 years of age. The subject still maintains all the functional utility for which it was designed. This can be shown by the increased occupancy rate from 91% up to 95.7%. The subject has not been decertified by the State and is still serving the purpose at a high level for what it was designed for. In an older facility that maybe even exceeds its chronological age, you would expect the opposite to happen.

McCann recognizes that properties such as the subject have a business value associated with it. McCann testified that the difference between classifying the subject as a "B" or a "C" only relates to the subject's estimated value utilizing the cost approach. McCann admitted that page 72 of his report refers to the subject as a special use property. However, he believes Foley, the person who helped prepare the McCann Report, meant a special purpose property. The difference being that a special use property has no demonstrable market for the purchase or sale of such properties, whereas a special purpose property such as the subject was design and used for special purposes which are not easily adapted to other kinds of uses such as a motel, office building or other use. McCann opined that there would be no significant difference in value for the subject from 2004 to 2005.

During rebuttal, the appellant called Richard Hansen as a witness. Mr. Hansen is an architect who owns Hansen Associates Architects. He has a Bachelor of Architecture degree. His firm specializes in retirement and nursing home design. He began designing nursing homes in 1970 and has designed 16 new nursing homes and approximately 100 additions or remodels. He inspected the subject February 14, 2008. His firm performed small remodeling jobs for the subject building in 1981, 1989, 1994 and recently in 2008. Hansen found the subject to be typical, or in average condition, when compared to other nursing homes built in the 1970's. Hansen testified that the difference between a Class "B" building and a Class "C" is that a Class "B" is a reinforced concrete frame construction, columns, beams and floors. It is all formed or precast concrete. The subject is not a reinforced concrete frame building. The subject is fire resistant and has masonry load bearing walls. The subject's floors, both upper and lower, are precast concrete. Hansen would classify the subject building as a Class "C" - low cost because the subject has a simple entrance. Even though the subject has a hot and cold chilled water heating and cooling system, a little higher category, he would still classify the subject as Class "C" - low cost. Class "B" and Class "C" are very similar, except for the little ornamentation on the exterior and a simple entrance.

VanSanten was recalled as a witness during the appellant's presentation of rebuttal evidence. VanSanten stated that entrepreneurial profit is related to the construction costs of a property and the incremental profit that a developer might expect to achieve upon completion of a reconstruction of a project. Entrepreneurial profit does not apply to nursing homes. Upon reviewing the Marshall Valuation Services data regarding convalescent hospitals, he believes the subject is a Class "C." His opinion is based on a combination of his own physical inspection of the subject and his understanding of the definition of a Class "C" building as defined within Marshall Valuation Service and corroborated by architect Robert Hansen. VanSanten pointed out that Class "B" requires the use of a reinforced concrete frame in which the columns and beams can be either formed or precast concrete. Class "C" is defined as masonry or reinforced concrete construction with the walls being load bearing. VanSanten opined that the subject was average. He explained that Marshall Valuation Service provides a way to make an adjustment for the heating and cooling by deducting for the per unit incremental cost of a higher end chilled water system and a package air-conditioned system. VanSanten testified that there is a substantial difference between the calculations for a Class "C" average and a Class "B" good. Class "B" good has a unit cost of $209 per square foot, whereas a Class "C" average is $118 a square foot. After adjustment for heating and cooling, the subject would have a unit cost of $133 per square foot. Trending the 2008 Marshall Valuation Service costs back to 2004, VanSanten stated that assuming the subject was Class "C" average, it would have a value of $4,492,731. In 2003 it would have a value of $4,296,324 before depreciation.

During cross-examination, VanSanten admitted he only spent about one hour inspecting the subject prior to the date of the hearing. He looked at the interior and exterior, but did not have access to any plans or specifications for the building. The valuation estimates from the Marshall Valuation Service data that he just testified to were dated November 2007 which he backed to January 1, 2004 using Marshall's cost indices. VanSanten admitted that the Marshall Valuation Service cost sheet states Class "B" in general is reinforced concrete that is fireproof and could be load bearing brick walls.

After hearing the testimony and considering the evidence the Property Tax Appeal Board finds that it has jurisdiction over the parties and the subject matter of the appeal. The Board further finds the evidence in the record supports an increase in the subject's assessment.

The appellant contends the market value of the subject property is not accurately reflected in its assessed valuation. When market value is the basis of the appeal the value of the property must be proved by a preponderance of the evidence. National City Bank of Michigan/Illinois v. Illinois Property Tax Appeal Board, 331 Ill.App.3d 1038 (3rd Dist. 2002). The Board finds the board of review met this burden of proof and an increase in the subject's assessment is warranted.

A primary issue in this appeal is whether VanSanten properly calculated a business value component in estimating the market value for the subject property. The appellant argued that a reduction was required because the subject property's value included intangible assets. It was argued that intangibles such as the Certificate of Need and license added value to the subject which must be deducted in order to determine the true value of the real estate. In order to account for the value of these attributes, the appellant's appraiser illustrated the difference in value between the subject's cost approach, income approach and sales approach. Based on the evidence and testimony in this record, the Property Tax Appeal Board finds the value of $7,900,000 attributed by VanSanten to the subject's intangible assets is not supported by credible testimony, substantive documentary evidence or accepted appraisal theory.

VanSanten's appraisal failed to provide credible evidence to quantify a business value component in estimating the market value for the subject property. VanSanten offered no substantive evidence depicting the sales comparables contained within his appraisal included a quantifiable business value component. Counsel for the appellant argued that the Real Estate Transfer Declaration sheets, which are certified under penalties of law and recorded as being true and correct, are not to be trusted as a true indicator of a property's purchase price for real estate. The appellant failed to provide substantive evidence to support this allegation through conversation with parties to the transactions stating the price on the Transfer Declaration sheets reflect more than the net consideration for the real estate. Further, McCann, the board of review's appraiser, undermined this argument wherein the Real Estate Transfer Declaration sheet for one of his sales comparables depicted personal property of approximately $2,000,000 was transferred and recorded.

The method most relied upon by VanSanten to quantify the business value component was one in which he compared the value developed using the income approach to the value developed under the cost approach analysis. Any difference between the two, VanSanten attributed to business value. VanSanten admitted during cross-examination that the 10% real estate capitalization rate that was used in his most reliable method for determining business value was not specifically supported in the REAC Report. The Board finds it problematic that a method which has not been universally accepted within the appraisal field would not be sufficiently detailed to justify its credibility.

The Property Tax Appeal Board placed little weight on VanSanten's method for quantifying business value. The difference between the two approaches may be attributable to other factors, including, but not limited to, the substantial errors contained within the REAC Report. These errors were significant in that VanSanten, who signed off on the REAC Report in September 2005, and only inspected the subject property immediately before the hearing, was required to change his opinion of value at the time of hearing. VanSanten provided no authority for acceptance of his method of quantifying business value by professionals, treatises relied upon by professionals within the appraisal field such as the <u>Uniform Standards of Professional Appraisal Practice</u> or other experts within the appraisal field of study. In fact, VanSanten testified that "[t]he concept of business enterprise value definitely has been widely accepted. The method for quantifying it is still a matter of debate within the appraisal industry." (Transcript, p. 85). The Board also finds that it is plausible that the difference between the two approaches to value may be attributable to incorrectly classifying the subject property under the cost approach. The Property Tax Appeal Board is not persuaded that the subject's correct classification is Class "C" as VanSanten determined. As counsel for the board of review pointed out, the <u>Marshall Valuation Service</u> cost sheet, when read in its entirety, depicts "[t]he primary characteristic of a Class B building is the reinforced concrete frame in which the columns and beams can be either formed or precast concrete. They may be mechanically stressed. It is a fire-resistant structure. Floors and roofs in Class B structures are formed or precast concrete slabs. . . . [i]n some Class "B" buildings, the walls may be partially load bearing." (Transcript, p. 248-249). Hansen testified that the subject contained fire resistant masonry load bearing walls with precast concrete floors. Thus, the Board finds the opinion of whether the subject is Class "B" or Class "C" is subjective at best and may require more than just a cursory examination of the subject prior to hearing.

The appellant's appraisal (REAC Report), estimated a value of $2,300,000 as of January 1, 2003. This estimate of value was subsequently amended at hearing to $2,100,000. The board of review's appraisal (McCann Report), estimated a value of $4,200,000 as of January 1, 2004. Both Reports utilized the three traditional approaches to value when estimating the market value of the subject property.

In estimating their respective land values, both appraisers used comparable land sales. The appellant's appraiser concluded a land value for the subject of $4.00 per square foot of land area or $500,000. The board of review's appraiser also concluded a land value for the subject of $500,000. The land sales submitted by both parties ranged from $0.62 to $5.12 per square foot of land area. The Board finds that a total land value of $500,000 as stipulated to by the parties is supported in this record.

In estimating the replacement cost new of the subject improvements, the appellant's appraiser estimated a replacement cost new of $4,286,873 less physical depreciation of 60% or $2,572,124 for a total depreciated value of the improvements of $1,714,749. The appellant's appraiser subsequently amended his opinion of the subject's total economic life to 45 years as opposed to 50 years based on his revised depreciation of 67%. Because of these changes, VanSanten estimated the subject's depreciated value of improvements was $1,597,874. After adding in the land value of $500,000, VanSanten amended his conclusion of value for the subject under the cost approach to be $2,100,000.

The board of review's appraiser estimated the subject's replacement cost new of the improvements to approximate $7,197,154 ($6,022,121 above grade + $1,175,033 basement area). McCann then applied a 50% depreciation factor and added a land value of $500,000 to depict a value for the subject via the cost approach of $4,100,000.

The Board finds the primary difference in the appraisers' respective estimates of value through the cost approach was in their estimations of depreciation and classification. Both parties utilized the age/life method to determine depreciation. VanSanten testified that the appraisers used their own opinion of what they thought the economic life of the subject would be to arrive at a revised depreciation of 67%. McCann testified that the subject indicated an effective age of 25 years even though the subject was actually 30 years old. He estimated the subject's total economic life to be 50 years for a 50% depreciation factor. McCann's estimate was based on his personal inspection of the property at the time of preparation of his appraisal in which he described the property as being in good condition. The appellant's own witness, Robert Hansen supported this testimony in describing the number of years his firm had performed a remodel or updates to the subject. VanSanten's estimate was based on the opinion of other persons who personally inspected the subject property at the time the REAC Report was prepared. These persons were not present at the hearing to offer direct testimony or to be subject to cross-examination regarding their experience, observations, methods or estimates. Further, VanSanten testified that he relied upon the observations of David Schoenike at the time the REAC Report was prepared. For these reasons, the Board finds the credibility of the testimony and the final value conclusion contained within the REAC Report are diminished. It was not until VanSanten inspected the subject immediately prior to the hearing that he felt his opinions required amendment. Even then, his inspection only lasted approximately one hour with no plans or specific documentation available to him. The Board finds McCann's testimony and cost approach analysis to be more credible.

Further, the appellant through VanSanten and Hansen attempted to show McCann used the wrong classification for the subject. It was their proposition that the subject was more properly classified as a Class "C" - low. However the Board accorded their testimony on this issue little weight. VanSanten did not use the Marshall Valuation Service cost index in his analysis, could not determine the correct year of the index from which he was testifying and presumed the index was applicable to all buildings, including nursing homes. Next, the Board is not persuaded that Hansen has sufficient familiarity with the Marshall Valuation Service cost sheets to make an informed opinion as to the correct definition of a Class "B" or Class "C" nursing home using the Marshall Valuation Service. Hansen testified as to his architectural background, however, he also testified that the first time he had seen the Marshall Valuation Service cost sheets was approximately a week prior to the hearing. For these reasons less weight is accorded to the cost approach to value submitted and later revised by the appellant's appraiser.

Under the income approach to value, the appellant's appraiser estimated a market value of $2,315,000 and the board of review's appraiser estimated a market value of $4,200,000. VanSanten's estimate of $2,315,000 is predicated on deducting a business value of $7,800,000. As previously discussed the Board gave VanSanten's method of allocating business value little merit.

VanSanten used the Medicaid rate paid for nursing home residents and an analysis of industry data to arrive at a projected daily rate per patient day of $135 with a stabilized occupancy of 94% to arrive at an estimate of the subject property's potential annual gross income of $5,373,000. After deducting expenses and personal property ($3,987,000), VanSanten estimated a stabilized net income for the subject of $1,386,000. McCann, on the other hand, used four years of actual income records with an occupancy rate of 95% and an average revenue rate of $4,000 per bed per year to arrive at a net operating income of $418,760.

In regard to the capitalization rate to be applied, VanSanten used 13% while McCann used 10%. Using the band of investment technique VanSanten examined capitalization rates from five sales comparables which is set forth in the REAC Report at page 105, published investment surveys, and consideration of the mortgage equity approach in order to arrive at a rate of 13%. McCann reviewed sales data where lease information was available. He then considered the mortgage equity approach, the average capitalization rates of skilled nursing facilities, publications and surveys to arrive at a capitalization rate of 10%. McCann did not believe it was appropriate to load the capitalization rate with an effective real estate tax rate.

VanSanten admitted during cross-examination that the effective tax rate depicted in the REAC Report on page 107 was actually 2.96% as opposed to 3.0%. He further admitted that a higher tax rate would result in a lower value for the subject when applied in the calculation of the overall capitalization rate. VanSanten then opined that the real estate was subject to property taxation, not the business value or personal property, so in an effort not to penalize the real estate value, the full effective tax rate of 3.0%, as depicted was adjusted to 0.7% based on the estimated proportion of real estate value. This amount was added to the overall rate of 13% to arrive at a total capitalization rate of 13.7%.

VanSanten applied the 13.7% capitalization rate to the subject's estimated net income to arrive at an indicated value by the income approach of $10,115,000. However, he then deducted $7,800,000 of business value to arrive at the subject's indicated value using the income approach of $2,315,000, rounded. McCann applied a 10% unloaded capitalization rate to the subject's estimated net operating income of $417,760 which indicated a value for the subject using the income approach of $4,200,000, rounded.

The Board finds VanSanten's estimated value using the income approach is predicated on his estimate of value using the cost approach. This is because he opined that $7,800,000, which was later amended, represents the difference between the income value and cost value, is the value of intangible assets. Based on the credibility of the witnesses and the evidence presented the Board finds VanSanten's estimate of value for the subject using the income approach is unsupported with substantive documentary evidence.

Further, the Board finds that McCann's market value estimate using the income approach to value is based on a review of market rents within the subject's immediate area of northern Illinois. The rents were considered credible based on required reports submitted on behalf of nursing homes. The market rents ranged from $2,249 to $4,924 per unit bed. The Board finds McCann's estimate of $4,000 per unit bed on an absolute net lease basis to be reasonable and well supported in the record. McCann next considered the subject's actual income and expenses during the preceding four operating years. Even though the subject displayed an increase in occupancy, McCann applied a conservative vacancy factor of 5%. McCann estimated a 10% capitalization rate using lease information, published documents, surveys and sources commonly relied upon by commercial appraisers. The Board finds McCann provided credible testimony regarding his analysis and methods and supported his estimate of value contained within his appraisal. McCann was well prepared at hearing with his work file available to provide detailed answers regarding his sources of data. Therefore, the Board gives greater weight to McCann's estimate of value using the income approach.

The Property Tax Appeal Board further finds the best evidence to estimate the subject property's market value contained in this record is in the comparison and analysis of the comparable sales contained in the market approach to value prepared by McCann. The courts have held that where there is credible evidence of comparable sales, these sales are to be given significant weight in estimating a market value of a similar property. Chrysler Corp. v. Illinois Property Tax Appeal Board, 69 Ill.3d 207 (2nd Dist. 1979); Willow Hill Grain, Inc. v. Property Tax Appeal Board, 187 Ill.App.3d 9 (5th Dist. 1989). The Board finds there are credible market sales contained in this record.

Utilizing the sales comparison approach to value, the parties submitted eight sales comparables. The appellant's sales number 2, 3, and 4 were the same sales submitted by the board of review as sales number 5A, 5B and 5C[10]. McCann's Report depicts six total sales while VanSanten's Report depicts five total sales. Three of the sales contained within VanSanten's Report were derived from an allocation of a three facility sale. VanSanten derived a sales price ranging from $31,806 to $52,587 per unit bed for these three sales. McCann also used these same three comparables and derived a sales price of $40,000 per unit bed. Neither appraiser provided substantive documentation to verify the allocated unit price per bed for these three sales. Based on the conflicting data regarding these three sales, location and with the reported sales price for each individual property being the result of an allocation from a combined three facility sale, the Board gave less weight to these three sales in its analysis. The Board also gave less weight to the appellant's sale comparable number one because its land to building ratio is significantly different when compared to the subject and because it has an occupancy rate of only 68% compared to the subject's occupancy rate of 94%. This would suggest to the Board that the condition of this comparable sale is below average; demand in the market area for this comparable is lower than the demand in the subject's market area, or both. The Board finds the remaining comparables were most similar to the subject's northern Illinois location. They sold for prices ranging from $75.25 to $181.43 per square of building area, including land or from $33,150 to

[10] These three sales comparables were used by each party; however, the reported dates of sale were different.

$60,000 per unit bed. After making adjustments to the comparables for differences when compared to the subject for such things as physical characteristics, size, location, frontage, zoning and date of sale, McCann determined that $37,500 per unit bed or $4,350,000 (116 beds x $37,500) was appropriate for the subject. McCann's Report included a detailed description of the comparables and a narrative analysis of the adjustment process. The Board finds McCann used clear and logical adjustments to estimate the subject's market value using the sales comparison approach. For these reasons, the Board gives more weight to the conclusion of value contained in McCann's sales comparison approach which supports his overall value conclusion.

In conclusion, the Property Tax Appeal Board finds the board of review submitted the best evidence regarding the subject's fair market value. Thus, the Board finds the subject property had a market value of $4,200,000 as of January 1, 2004. Since market value is established the 2004 three year median level of assessments for Boone County of 33.48% shall apply, resulting in a total assessment of $1,406,160.

This is a final administrative decision of the Property Tax Appeal Board which is subject to review in the Circuit Court or Appellate Court under the provisions of the Administrative Review Law (735 ILCS 5/3-101 et seq.) and section 16-195 of the Property Tax Code.

Chairman

Member

Member

Member

Member

DISSENTING:

C E R T I F I C A T I O N

As Clerk of the Illinois Property Tax Appeal Board and the keeper of the Records thereof, I do hereby certify that the foregoing is a true, full and complete Final Administrative Decision of the Illinois Property Tax Appeal Board issued this date in the above entitled appeal, now of record in this said office.

Date: November 25, 2009

Clerk of the Property Tax Appeal Board

IMPORTANT NOTICE

Section 16-185 of the Property Tax Code provides in part:

"If the Property Tax Appeal Board renders a decision lowering the assessment of a particular parcel after the deadline for filing complaints with the Board of Review or after adjournment of the session of the Board of Review at which assessments for the subsequent year are being considered, the taxpayer may, within 30 days after the date of written notice of the Property Tax Appeal Board's decision, appeal the assessment for the subsequent year directly to the Property Tax Appeal Board."

In order to comply with the above provision, YOU MUST FILE A PETITION AND EVIDENCE WITH THE PROPERTY TAX APPEAL BOARD WITHIN 30 DAYS OF THE DATE OF THE ENCLOSED DECISION IN ORDER TO APPEAL THE ASSESSMENT OF THE PROPERTY FOR THE SUBSEQUENT YEAR.

Based upon the issuance of a lowered assessment by the Property Tax Appeal Board, the refund of paid property taxes is the responsibility of your County Treasurer. Please contact that office with any questions you may have regarding the refund of paid property taxes.