FINAL ADMINISTRATIVE DECISION
ILLINOIS PROPERTY TAX APPEAL BOARD

APPELLANT: First of America Trust 977
DOCKET NO.: 05-01511.001-C-3
PARCEL NO.: 05-36-228-017

The parties of record before the Property Tax Appeal Board are First of America Trust 977, the appellant(s), by attorneys James E. Tuneberg and Edward Maher, of Guyer & Enichen, P.C. in Rockford; 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 ***a reduction*** 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:	$ 61,599
IMPR.:	$ 349,188
TOTAL:	$ 410,787

Subject only to the State multiplier as applicable.

ANALYSIS

Prior to the hearing the parties stipulated that the 2003, 2004 and 2005 appeals should be consolidated for purposes of appeal and that the assessed value established by the Property Tax Appeal Board for year 2003 will carry forward for 2004 and 2005, subject to the applicable township equalization factor.[1] Thus, decisions for assessment years 2004 and 2005 will be issued separately.

The subject property consists of a 77,440± square foot site improved with a 118-unit, 13-story apartment building containing approximately 85,082± square feet of gross building area located in the City of Belvidere, Belvidere Township, Boone County. The fully sprinkled building was completed in 1977 and features a

[1] Subsequent to the hearing, the board of review indicated without objection that no local equalization factors were applied in 2003 and 2004 for commercial properties in Boone County. In 2005 the board of review utilized an equalization factor of 1.015 for commercial property.

concrete exterior facade with a flat roof. Features include two, 2,500 pound elevators and a 484± square foot detached frame garage. The first floor includes a management office, lounge area, community room, storage areas and a maintenance/equipment room. The second floor contains eight residential units, a laundry room, activity room, beauty salon and a craft room. The remaining floors each contain ten residential units per floor. Each unit is a one-bedroom, one bath configuration ranging in size from 502 to 572 square feet of living area. The subject is improved with approximately 90± asphalt paved parking spaces. The building was designed as a senior rental apartment complex subject to an existing agreement between the owner(s) and the Department of Housing and Urban Development ("HUD") and a Housing Assistance Payment ("HAP") rental subsidy agreement.

The parties further stipulated that their respective appraisers, Terry Heilman, John Hill and William Farina qualify as expert valuation witnesses for purposes of the consolidated hearing.

In addition, it was agreed that the subject property is enrolled in two, 40-year government agreements, namely, an original agreement with the Illinois Housing Development Authority ("IHDA"), dated January 2, 1979, and amended May 1, 1993, and a U.S. Department of Housing and Urban Development Section 8 Housing Assistance Payments Program for Housing Assistance Payments contract ("HUD/HAP"), dated March 1, 1997.

In summary, the IHDA contract has an initial term of five years with seven additional five year extensions up to a maximum of 40 years. The regulatory agreement does not allow the owner to terminate the contract prior to the maximum term of 40 years. Under the HAP agreement occupancy participants must be of low or moderate incomes. Rents are controlled, which are set on a budget basis at a level sufficient to make limited dividend payments, mortgage payments, reserve payments and operating expenses, less other income and a vacancy allowance. The agreement also regulates the required payments for replacement reserves. This project, typically known as a limited dividend housing project, has a restricted income distribution which was set when the property was first built and is based on a maximum return on the original equity investment. The owner's cash flow cannot exceed the maximum distribution. Cash flow exceeding the maximum distribution (excess income) is used to reduce rents or increase reserve balances. HAP provides a rent subsidy that both parties agree is above standard market rental rates. The regulatory agreement allowed for an annual limited distribution of 6% of the owners' original equity in the development. This amount was increased to a maximum of 12.8% pursuant to a 1993 refinance agreement allowing for a $57,837 annual distribution to the owners based on a $451,495[2] equity investment. The

[2] This amount was incorrectly depicted throughout both parties' respective appraisals as $415,495.

restrictions run with the property and cannot be removed until the HAP agreement expires in February 2017.

The appellant, through counsel, appeared before the Property Tax Appeal Board claiming the fair market value of the subject was not accurately reflected in its assessed value. In support of this argument counsel for the appellant referred to several cases regarding valuation of subsidized housing. The Supreme Court in Springfield Marine Bank v. Property Tax Appeal Board, 44 Ill.2d 428 (1970), found that the capacity for earning income, rather than actual income reflects fair cash value for taxation purposes. In Kankakee County Board of Review, 163 Ill.App.3d 811 (1987), the court held that a rent subsidy agreement that affects a property's true capacity for earning income cannot be ignored in the assessment of that property. In Lake County Board of Review v. Property Tax Appeal Board, 172 Ill.App.3d 851 (1988), the court requires contract rent in a subsidized housing complex to be accounted for in determining value.

Appellant's counsel first called Colleen Carter as a witness. Carter is employed by Architektur 80. She handles the accounting aspects of the subject, oversees governmental compliance and supervises the residential holdings. Carter testified that the subject was not developed as a Section 515 project, nor was it developed using tax credits as a Section 42 project. The IHDA and HAP agreements differ from a 515 and Section 42 program. Architektur 80 has a management contract for the subject. IHDA reviews and approves all expenses related to the property. The replacement reserve account is used for capital improvements to the building or to the apartments. IHDA holds the fund and is in charge of approving withdrawals from the account and stipulates as to how much is put into the account every month. The owners do not have access to the funds in the replacement reserve for use other than a purpose expressly permitted by IHDA. The residual receipts consist of excess cash or income accumulated at the end of the year. IHDA determines the amount of money put into that account after a review of the subject's income and financial statements. Withdrawals from the residual receipts fund cannot occur without IHDA approval. At the termination of the program in 2017 the monies held in the residual receipts account goes back to IHDA. In 2003, 2004 and 2005 the approximate balance in the residual receipts account was $84,000. IHDA approves an annual distribution (limited dividend) to the owners of the subject if the income and expenses meet a debt coverage ratio. The limited dividend amount is $47,837 plus a $10,000 management incentive fee. These amounts are not paid if the subject does not reach the debt coverage ratio. The limited dividend of $47,837 can be carried over and paid in any future year if there is surplus cash in future years. The $10,000 management incentive fee is not carried over and is completely lost if the debt coverage ratio is not met in any given year. Carter testified that there have been years when the limited dividend and management incentive fee have not been paid.

Carter further explained that the subject required a new elevator, had very limited parking, was not close to recreational activities for the residents, was not close to shopping and no public transportation was available at the subject's location. In order to correct the problems, three bids would have to be submitted to IHDA for approval providing there were sufficient replacement reserve funds available.

During cross-examination, Carter testified that residents pay 30% of their personal income towards the monthly rent, and then the HUD program subsidizes this amount to a total subsidized rent of $700 per unit. The subject's monthly income comes from the subsidized rents of $700 per unit and from interest earned on the reserve accounts that IHDA control. In addition, there is laundry income and rental income for an antenna on the roof. Normal expenses include management expenses, lights, utilities and snow removal. The subject's income less expenses is considered net operating income. Out of this net operating income, the mortgage ($42,000± per month) is paid and the replacement reserve account is funded. If excess money exists then that amount is distributed to the limited partners as their distribution. After the limited dividend distribution, IHDA determines the amount to be funded into the residual receipts account. Interest in the residual receipts account is funded back to the property's operating account every quarter as income. The debt coverage ratio for the subject during the assessment years in question was approximately 1.15. In 2003, 2004 and 2005 the subject did not have any vacancies. The elevators were replaced in 2005 at a cost of $250,000. IHDA approved $200,000 from the replacement reserve fund and a general partner funded the remaining $50,000. A promissory note was given to the general partner for the $50,000 which was added to the debt service for the subject. The limited dividend of $57,837 was determined at the time the mortgage was put into effect. For the assessment years in question, IHDA required replacement reserves for the subject of approximately $3,000 per month. Further, when the general partner provided $50,000 for the elevator replacement, the debt service ratio for the subject increased.

The next witness called on behalf of the appellant was Terry Heilman. The parties stipulated to Mr. Heilman's qualifications as an expert witness. Heilman, an Illinois Certified Real Estate appraiser, was employed by John P. Hill and Associates, Ltd. during preparation of the appraisal report for the subject. He has 2± years of appraisal experience in commercial and income producing properties.

Heilman stated he was familiar with the government program associated with the subject. The subject had a Section 8 subsidy and also had an IHDA loan. Heilman testified that the subject is not associated with the Section 515 or the Section 42 government programs. Pursuant to his understanding of Illinois case law and

previous Property Tax Appeal Board decisions, he attempted to identify the positive and negative effects that the specific IHDA and HAP government agreements had on the subject.

Heilman testified that a positive effect of the government agreements is the Section 8 subsidy provides above market rents. This in turn should give the owner enough money to provide adequate reserves to maintain the condition of the property. In addition, at the end of the project, the property will be free and clear. The negative aspects of the agreements would include the restricted dividend of $57,837 per year. Heilman stated that this restricted dividend runs with the property. Another negative aspect is that at the end of the term an owner has a 13-story building that consists of small, unmarketable, one-bedroom, 500 square foot units with limited parking.

Heilman used the cost and income approaches to estimate the subject's value as of January 1, 2003. The sales comparison approach was not developed because he was unable to find similar sales of comparable properties. He primarily relied on the income approach to estimate the subject's final value.

Under the cost approach, Heilman utilized three land sales in the subject's market area that sold from April 2000 to September 2002 for prices ranging from $3.05 to $4.86 per square foot. Heilman determined the subject's land value to be $3.45 per square foot or $265,000 rounded.

In determining the replacement cost of the subject building, Heilman utilized the Marshall Valuation Service for Class C construction. The indicated replacement cost was $58.29 per square foot or approximately $4,959,495. A replacement cost for the garage was $20.00 per square foot or $10,500. Elevator replacement cost of $300,000 and a 10% entrepreneurial profit of $527,006 were added to these replacement costs for a total building replacement cost of $5,797,061. Site improvements of $97,500 and 10% entrepreneurial incentive of $9,750 were added to the building replacement costs to arrive at a total replacement cost new of $5,904,311.

Heilman next estimated the subject's physical depreciation using the Marshall and Swift manuals. Using the age/life method he estimated 30% depreciation for the subject or $1,739,118. He did not use functional obsolescence because the subject as currently used was at full capacity. For external obsolescence he developed an income approach fee simple and then compared that to an income approach with a discounted cash flow that included the encumbrances of the IHDA mortgage. The difference between the two amounted to 55% or $3,188,384 which was added to the physical depreciation to arrive at a total depreciation for the building of 85% or $4,927,502. Site improvement depreciation of $91,163 was added to the building depreciation amount to arrive at a total depreciation for the subject building and site improvements

of $5,018,665. Subtracting the depreciation amounts from the total replacement cost indicated a total depreciated value of the building and site improvements of $885,646. Adding the land value of $265,000 indicated a total depreciated replacement cost new, subject to government restrictions, for the subject of $1,150,000 rounded.

In preparing an opinion of value using the income approach Heilman valued the property both as restricted by the government agreements and as unrestricted. This method was used so that he could analyze the property to determine what the negative value was to the property based on the differences between a standard fee simple apartment building and an apartment building restricted with a limited dividend.

Heilman developed an overall capitalization rate which was used to determine value for both the restricted analysis and the unrestricted analysis. He used the mortgage equity technique which assumes a 75% mortgage with a 25% equity term. Using a 6.5% mortgage rate and a 12% equity rate he developed an overall capitalization rate of 9.71%, he then added a real estate tax load factor of 2.44% for a total loaded capitalization rate of 12.15%. As unrestricted, market rents of $575 per month for 118-units with a 2% annual increase indicated rental income for the subject of $814,200. Vacancy and collection losses were estimated at 6% to arrive at a net rental income of $765,348. Other income of $9,914 was added to indicate total income of $775,262. Total expenses consisting of administrative fees, management fees, operating expenses, maintenance fees, reserves for replacements and other various fees totaling $445,516 were deducted to arrive at a net operating income for unrestricted property of $329,746. Using the 12.15% capitalization rate developed earlier, Heilman estimated the subject's fee simple market value, as if unencumbered with HUD restrictions, was $2,715,000 rounded.

Heilman next developed an income approach to value for the subject considering the government restrictions currently applying to the property. Heilman calculated a 15-year discounted cash flow analysis using two components, the limited dividend restriction of $57,837 and the reversionary value. For the limited dividend component Heilman used a 5% capitalization rate because the $57,837 a year was essentially guaranteed. He stated this 5% was similar to the treasury amounts between the 10 and 20 year Treasury note rates. He understood the limited dividend was not guaranteed, however, he felt that it was a conservative way of approaching this method. To develop the reversionary value of the building he calculated 15 years of cash flow and in the 16th year he used market rents, vacancies, market income and market expenses to arrive at a net operating income of $503,960. For the reversionary value he used the $503,960 net operating income in year 17 and divided it by the 12.15% capitalization rate that was developed earlier using the mortgage

equity technique. He did not include the property tax obligation as an expense because his analysis was for assessment purposes and the taxes were unknown. In the alternative, he used a loaded capitalization rate of 2.44% or one-third of the assessor's rate of 7.329% that is based on fair market value.

Heilman next valued the limited dividend stream of income for years 1 through 15 discounted at a 5% rate. Heilman calculated the net income upon termination of the project at $503,960 and divided that by a capitalization rate of 12.15%. He then subtracted a 3% sales cost and discounted it to a present value based on a 13.32% market discount rate. He stated the present value in the 15th year at a 13.32% discount rate is .153. The tax load is included in the market discount rate of 13.31%. For this income capitalization approach, using the discounted cash flow analysis with HUD restrictions, Heilman estimated the subject's fee simple market value to be $1,215,000.

In reconciling the two approaches to value, Heilman did not feel the cost approach was as relevant. He examined the static analysis and the discounted cash flow analysis and felt the static analysis was a tool to look at for determining depreciation. He placed primary emphasis on the discounted cash flow analysis which considered the HUD restrictions.

During cross-examination, Heilman acknowledged he does not have an MAI designation from the Appraisal Institute. John Hill helped in the preparation of the appraisal. He stated that the restriction on the subject's income dividend was the reason the subject's value dropped from $2,715,000 to $1,215,000. Heilman admitted he did not have any comparable sales of unsubsidized apartment buildings to justify his estimated value without HUD restrictions. Heilman was questioned on the differences between market value and investment value. He stated that the problem in this case was that the mortgage cannot be separated from the property because there is a restriction on sales. Any potential buyer within the 16 year period would purchase the property subject to the program restrictions. Heilman acknowledged that as of December 31, 2002 the subject had a book value at cost of $162,506 for the land and $4,083,033 for the building. In estimating external obsolescence Heilman looked at the difference between the value as developed in the income approach by comparing the fee simple value to the value with HUD restrictions. Heilman admitted that he adjusted the subject's cost approach value to conform to the income approach because the cost approach relies on value estimates derived from the income approach. He admitted that if there was an error in the income approach that would be carried over as an error in the depreciation calculation.

During re-direct, Heilman stated that the subject's net operating income, standing alone in each year, does not have any independent value in his analysis because the investor is limited

to $57,000± per year. If the subject had a net income of a million dollars, it would not matter because the investor is limited to his $57,000±. A one million dollar net income may bump the reversionary value because the reversion is set at market rents when the project ends. If the net operating income for the subject in any given year were zero or a negative number, then the owner would be in trouble because he would not even end up with a building at the end of the project term. His present value of reversion, which totaled $616,000, assumes the subject will be free and clear of any mortgage; however, that value would not change if the subject maintained a mortgage because that amount is computed prior to debt service. Based on this evidence, the appellant requested the subject's assessment be reduced commensurate with Heilman's estimated final value conclusion for the subject of $1,215,000.

The board of review submitted its "Board of Review Notes on Appeal" depicting the subject's total assessment for 2004 in the amount of $1,149,259. The subject has an estimated market value of $3,432,673 as reflected by its assessment and Boone County's 2004 three-year median level of assessment of 33.48%. The board of review requested an increase in the subject’s assessment commensurate with the estimation of final value contained within the appraisal report submitted as evidence by the board of review.

In support of the subject's estimated market value, the board of review, through counsel, submitted an appraisal prepared by William Farina, president of Urban Appraisal, Incorporated. Mr. Farina has 29 years of experience appraising subsidized apartment projects. Farina has an MAI designation from the Appraisal Institute. Farina estimated the subject property had a market value of $4,130,000 as of January 1, 2003.

Prior to preparing the appraisal report Farina reviewed the regulatory agreements affecting the subject property. It was also his understanding that the HUD/HAP contract provided rents for all of the apartment units of $700 per month. The contract contained seven, five-year extensions out to the term of the mortgage agreement. The limited dividend concept means revenue generated by a property after payment of debt service cannot be simply taken away as earnings free and clear by the owners. Rather, only a certain fixed dollar amount based on a percentage of the original equity investment can in fact, be taken home as free and clear earnings. The balance of cash flow from the property, if there is cash flow, must either be put into a reserve account or put back into the property.

Farina defined "market value" as used in the appraisal as the

> [M]ost probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale with the buyer

> and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. In this definition the consummation of the sale on the specified date and the passing of title from seller to buyer under conditions whereby buyer and seller typically are motivated, both parties are well informed, well advised and acting in what they consider their best interest. Reasonable time is allowed for exposure in the open market. Payments made in terms of cash and the price represents normal consideration for the property sold unaffected by special or creative financing or sales concessions.

He defined investment value as "the value of an investment to a particular investor based on his or her investment requirements and reflects subjective relationships between a particular investor and a given investment." Farina stated the difference between "market value" and "investment value" is that "investment value" is the value of property to an individual, a specified individual with their own needs and requirements. Whereas, "market value" is the value to a broader range of typical potential buyers of the property.

In preparation of the appraisal, Farina relied upon the previous stated court decisions and previous Property Tax Appeal Board decisions. In addition, he consulted Appraisal of Affordable Housing by Mr. Polton, published by the Appraisal Institute, and also the 12th Edition of the Appraisal of Real Estate published by the Appraisal Institute. Farina stated the principle in both of these publications is a widely accepted method of valuing affordable housing properties and involves the addition of the equity and mortgage components. In short, this means the value of the equity component plus the existing mortgage on a property is equal to market value.

During his inspection of the subject he found the subject to be in average physical condition. The subject's highest and best use as improved is the current use of the property as affordable senior apartments. In his appraisal, he developed the three traditional approaches to value - the cost, sales and income approach. He gave the cost approach marginal weight because the estimation of depreciation is very difficult and very subjective.

In the cost approach to value Farina utilized the same three comparable land sales used by Heilman in his appraisal report. Following minor adjustments, Farina determined the subject's land value to be $3.50 per square foot of land area or $270,000 rounded.

In determining the replacement cost of the subject building, Farina utilized the Marshall Valuation Service for Class B construction. The indicated replacement cost was $85.74 per

square foot or approximately $7,362,065. A replacement cost for the garage indicated $24.75 per square foot or $11,979. Site improvements of $100,000 and a 10% entrepreneurial profit of $747,404 were added to these replacement costs for a total replacement cost of $8,221,449. Farina's appraisal depicts physical depreciation at 30% of replacement cost due to wear and tear. Farina's appraisal further depicts that the subject would not likely be economically feasible under the current economic climate absent the rental subsidy assistance associated with HAP. Operated without the HAP contract, the subject property would suffer from external obsolescence as a result of the fact that market rate rent levels have generally fallen below the rising costs of construction. Therefore, Farina estimated the subject suffers from external obsolescence totaling 10% of replacement cost new. In addition, Farina opined that the subject suffers from functional obsolescence of 10% of replacement cost given the lack of adequate on-site paved parking. Depreciation of 50% or $4,110,724 was subtracted from the replacement cost and an estimated land value of $270,000 was added to estimate the subject's value using the cost approach of $4,380,000 rounded.

Farina next developed a sales comparison approach to estimate the subject's value. He gave this approach marginal weight in his final value conclusion because subsidized properties, like the subject, rarely sell and the sales used in his appraisal were all larger unsubsidized apartment complexes.

Farina utilized five sales ranging in size from 34 to 272 units that sold from August 2000 to December 2003 for prices ranging from $26,923 to $65,882 per unit. The properties were located in Monmouth, Champaign, Urbana, Decatur and Springfield, respectively. The sales were adjusted for market conditions, location, visibility, micro location, size and amenities. Farina estimated a value for the subject using the sales comparison approach of $35,000 per unit or $4,130,000.

Farina next developed an estimation of value for the subject using the income approach. To develop this approach he used a discounted cash flow analysis. He stated the discounted flow analysis takes into account all of the benefits and detriments in a property's anticipated cash flow over a specified holding period. A net operating income is derived from the discounted cash flow analysis, which is discounted back to a present value for each year to a total value. Then the discounted value on the anticipated reversion at the end of the holding period is added to the total value.

Farina stated that he considered the subject's limited income dividend in his expense analysis and in his choice of capitalization and discount rates. Typically, limited dividend properties have higher expenses than unencumbered properties.

Farina considered limited dividends as a negative aspect of the subject. Other negative factors include additional paperwork that management must do in administration of the program. Positive aspects of the subject are that a Section 8 HAP contract is very lucrative and allows rents above the market rate. Another positive aspect of the limited dividend property is that properties of this nature tend to have very good maintenance and remain in very good condition. These properties typically have reserve accounts which are required by the housing agencies. Farina stated that another positive aspect is that there are many legitimate ways the reserve money can be put back into the property for things such as maintenance and other things as well.

Farina stated that the limited dividend in this case was stipulated as a percentage (13% or 14%) of the original equity investment and was set by IHDA when the agreement was made.

Farina testified that in terms of a limited dividend property, the expenses must be increased. After consideration of the positive and negative factors he chose an overall rate of 9% and a discount rate of 10%.

In his opinion, it is not appropriate to apply the discounted cash flow analysis to only the income dividend portion of the income distribution. The mortgage component must also be considered.

At the end of the HAP contract on the subject property a reduction of income is expected because the HAP Section 8 rents are above market levels and the owner can expect to see a reduction in revenues because the rents would revert to market rents appropriate for the subject's area.

Farina utilized five comparable rentals in Belvidere and Rockford. He estimated a market rent for the subject property of $595 per month per unit. The monthly rent under the HAP contract is $700 per month per unit.

He then used the $700 current rents for the subject and escalated them at a rate of 2.5% per year compounded throughout the duration of the cash flow projection. Farina determined a 5% vacancy and collection loss was appropriate based on vacancies of comparable properties being slightly higher. For operating expenses he examined the subject's historical expenses, the agreement and expense statistics published by the Institute of Real Estate Management for the subject's region. Farina then stabilized the expenses for the subject at approximately $4,500 per unit or 53% of gross potential income. For future anticipated operating expenses, he escalated the expenses higher because income will grow at a slower rate than the expenses will. He estimated expenses would grow at 3% per year compounded for the duration of the cash flow projection.

For reversion, he followed the same method as used by the appellant's appraiser. He examined the anticipated net operating income for year 16 (1st year after the end of the cash flow projection) and then assumed the potential buyer would capitalize that anticipated income as a going out rate of 9% and then deducted closing costs of 2%. This figure was discounted to a present value. The estimated final value using the income approach to value, consisting of the total sum of the discounted annual cash flow plus the discounted reversion, is $4,130,000.

In arriving at his estimation of value, Farina used an overall discount rate of 10% after examination of investor surveys published by Korpaz. The surveys depicted a range of typical discount rates for larger apartment projects which ranged from 9% to 15% with an average of 10.88%.

Farina placed most weight on the income approach to value to estimate a final value conclusion for the subject of $4,130,000 as of January 1, 2003.

During cross-examination, Farina acknowledged that he used an unloaded residual capitalization rate of 9% while the appellant's appraiser used a loaded rate of 13.32%. Regarding his unloaded capitalization for the discount rate, Farina admitted that if the subject's actual tax obligation increased, that amount would carry all the way through the entire year 1 through year 15 calculations, and could be significant. Farina admitted that his reported figure of $440,000 for the replacement reserve account really totaled $262,130 as of January 1. However, he stated the $190,000 difference would not impact his opinion of value for the subject.

Farina further testified that the subject's income or rent revenue actually received in year one was $700 per month per unit and that he increased the rent income 2.5% based on a clause in the HAP contract which states that annual adjustments are allowed for factors such as consumer price index. He admitted the contract depicts that annual adjustments may be requested but not granted. Upon hearing Colleen Carter's testimony that there was no increase in rental income and that it remained static at $700 per month for years one, two and three, he admitted that the $991,000 (revenue for years two and three) in his analysis was overinflated from what was actually received.

In addition, Farina testified that his final value conclusion of $4,130,000 included the contributory value and use of the furniture, fixtures and equipment ("FF&E") necessary for its operation. Farina stated that it was typical to include FF&E in a discounted cash flow analysis if it was located in a common area. However, he admitted not all of the FF&E was in a common area and his appraisal made no distinction for FF&E in a private area or common area.

Farina used the Marshall & Swift Valuation Service for Class B construction, however, nothing in his appraisal suggested why he used Class B. Farina testified that his comparable sales would require a significant adjustment in order to compare them to the subject property. However, on cross-examination, he admitted that in four out of the eleven adjustments, no adjustment was required and that in four other categories only minor adjustments were made. Farina stated he should have stated more of his adjustments in his appraisal. In retrospect, he agrees with the appellant's appraiser and would have disregarded the entire sales approach.

Farina considered the reserves for replacement a positive aspect in his discounted cash flow analysis. He understood that the reserve accounts had always been discretionary regarding if they were kept by IHDA or returned to the owner at the end of the contract. However, in his analysis he assumed they were returned to the owner.

Farina testified that his analysis in this case and the discounted cash flow analysis are consistent with a fee simple unencumbered standard discounted cash flow analysis. The only difference between a standard discounted cash flow analysis and the discounted cash flow analysis in this case was the .25 point rate adjustment in his analysis of an unrestricted property. This is because of the positive and negative aspects of the IHDA contract. Based on this evidence, the board of review requested an increase in the subject's assessment commensurate with Farina's estimated final value conclusion of $4,130,000.

In rebuttal, appellant's counsel called Anthony Uzemack as a witness. Mr. Uzemack is president of Appraisal Systems, LLC. Uzemack prepared a review of the Farina appraisal submitted by the board of review. Uzemack reviewed each approach to value developed by Farina.

Uzemack opined that the Farina appraisal, prepared in fee simple, subject only to the HAP agreement and the IHDA agreement for the subject property, was in error. Uzemack testified that he did not think Farina properly considered the negative and positive aspects of the agreements in place. Regarding the limited dividend income, he felt Farina made an omission. The limited income of $57,837 was enhanced with additional net income from the property's stabilized cash flow. Lumping the limited dividend in with the stabilized cash flow gave a distorted enhancement to the earning capacity of what could be exchanged in an actual sale between a willing buyer and a willing seller. However, the $300,000± that is in excess is controlled by the rules governing the operation of the property by the HAP and IHDA agreements. They are not readily available for exchange in the open market. He stated that if you cannot sell something, it has no market value.

Uzemack stated that Farina's methodology was referenced in a case study from the Valuation & Market Studies for Affordable Housing authored by Richard Polton, published by the Appraisal Institute. This publication is reasonably relied upon by experts in the appraisal field. The book was introduced into evidence as an exhibit by the appellant. Based on his understanding of the case study it states "[i]n evaluating the income component, the appraiser considers the length of time the property is likely to remain as a low-income development, the length of any contracts or subsidies, major issues regarding the condition of the building and operations, and anticipated condition of the property when the restrictions end." Uzemack testified that the analysis of the income component in valuing HUD property leads into another case study where the value conclusion of the income component is listed as the addition of the value of debt and equity. There is no mention of market value, and it is not the intent of the script to mention market value. The measurement is for equity and debt as it relates to subsidized property used in the case study. He stated that both appraisers were very close on reversion, however the controlling factors of the agreements dictate what is left on the table for the investor, and what is mandated by the control and maintenance of the property. This is one of the reasons he could not concur with the conclusion of value in Farina's appraisal.

In his opinion, Farina's appraisal does not adequately address the limited dividend component of the agreements in place. Uzemack went on to explain that the limited component is wrapped in the net operating income distributed across 15-years. The structure of the deal in impacting the appraised property is such that by government design the debt service is inherent in the net income. It is scheduled to retire the debt over an allotted period of time, 40-years in this case, with minor adjustments. If there are extra funds left over, then one of the recipients of that fund will be the investor in the original transaction or whoever the investor is at that particular time. If everything goes according to plan then you will have building reserves and extra reserves protecting the retirement of the debt. However, you cannot sell it or give it away.

Uzemack stated that the FF&E should have been segregated, isolated or identified in the appraisal. He felt that Farina should have included a value for the subject as unencumbered with the government agreements because it is an important indicator of determining what the anticipated reversion might be as unencumbered 15 or 16 years hence.

Uzemack testified that Farina's cost approach to value was inappropriate in this case based on Farina's declaration of highest and best use of the property if vacant, since it would remain vacant and undeveloped due to the lack of incentive and lack of market in the subject's area. He did not understand why someone would build something if it was not going to happen.

This could have been reflected in the obsolescence adjustment; however, it was not adequately done. Since Farina's cost approach did not comply with the highest and best use as defined in the appraisal, it was of no value or no support.

Uzemack did not believe the sales comparison approach provided meaningful value information because the comparables required significant adjustments of otherwise non-comparable properties. As stated in the Farina appraisal, the sales comparison approach was only included at the request of the client and for informational purposes. It was only marginally applicable.

Uzemack disagreed with Farina's appraisal on procedural and appraisal technique matters. For properties, such as the subject, the job was not done with adequate support and factual support.

During cross-examination, Uzemack testified that when preparing an appraisal for ad valorem purposes, the interest is in the value of the property in almost 95% of the situations, not the interest of the owning entity.

Uzemack stated that Farina did not consider all the positive and negative aspects of the government program in developing his estimate of value. He went on to explain that the management expenses, being a percentage of the effective gross income, become distorted in amount and capacity because of the excess amount of cash flow that is being generated. Farina considered the large cash flow generated under the HAP program in the first year of calculation; however, in subsequent years he brought it forth and inflated the cash flow by what would occur in subsequent years. He opined that predicting the cash flow, which may be erratic, from $700 per month per unit for a period of three years prior to a possible increase of 2% or 3% becomes suspect.

Uzemack stated that the value of the property was not worth the value of the down payment plus the mortgage because there is no measure of marketability based on what was invested into a property and the amount of debt that went against the property.

After hearing the testimony and reviewing the record, the Property Tax Appeal Board finds that it has jurisdiction over the parties and the subject matter of this appeal. The appellant argued the subject property's assessment was not reflective of its fair market value. When market value is the basis of the appeal, the value must be proved by a preponderance of the evidence. Winnebago County Board of Review v. Property Tax Appeal Board, 313 Ill.App.3d 179, 183, 728 N.E.2d 1256 (2nd Dist. 2000). The Board finds the appellant has met this burden and a reduction in the subject's assessment is supported.

The Board further finds the best evidence in the record as to the subject property's value as of January 1, 2003 is the appellant's appraisal prepared by Illinois State Certified General Appraiser, Terry Heilman.

The subject property operates under two government agreements - the Illinois Housing Development Authority ("IHDA") which provides governmental financing for construction and a rent subsidy agreement with the U.S. Department of Housing and Urban Development ("HUD"). In general, these programs require the subject's units be rented to low-income elderly tenants. The tenants pay approximately 30% of their net income for rent with HUD subsidizing that amount to secure above-market rents, currently in the amount of $700 per month per unit. Pursuant to the agreements, the appellant receives favorable financing and above-market rents, however, the appellant can only access $57,837 of the income stream which equates to 13% of the original developer's equity interest ($451,495). Income in excess of the $57,837 limited dividend is put in reserves that cannot be accessed by the appellant absent approval from IHDA.

The standard for determining the fair cash value of property is the price at which ready, willing, and able buyers and sellers would agree. Kankakee County Board of review v. Property Tax Appeal Board, 131 Ill.2d 1, 16 (1989). A property's income-earning capacity is the most significant element in arriving at its fair cash value for assessment purposes. *Id*. at 15. A taxing authority must weigh both the positive and negative aspects of a subsidy agreement and adjust the actual income figure to accurately reflect the true earning capacity of the property in question. *Id*. at 17. In Kankakee County, the Supreme Court held a subsidy agreement affecting a property's income-earning capacity must be considered in calculating fair market value if the property is designed for use as subsidized housing, its best and highest use is as subsidized housing, and it is transferable to others for use as subsidized housing. *Id*. at 18, 19.

Both appraisers agreed that the cost approach to value and the sales comparison approach to value provided little if any guidance in determining the subject's fair market value. Each appraiser, qualified as an expert, agreed that the best methodology to use in determining the subject's fair market value is the income approach to value. The Property Tax Appeal Board will give primary focus to the income approach to value prepared by the two appraisers in determining the correct assessment of the subject property. The record contained testimony that the cost approach should be given less weight. Additionally, each appraiser gave least weight to the cost approach to value. With respect to the sales comparison approaches to value, neither appraiser could locate, nor did either use as comparables, low-income subsidized apartment complexes. Only one appraiser used as comparables conventional apartment complexes that were not

designed, constructed or operated as low-income subsidized housing, as is the subject. Based on this record the cost and sales comparison approaches will be discussed, however, the Board finds that emphasis should be given to the income approach because the cost and sales comparison approaches were not shown to be clearly more appropriate methods of valuing the subject property.

Mr. Heilman prepared a complete summary appraisal utilizing the cost and income approaches to value wherein he estimated the subject's fair market value, subject to HUD restrictions, of $1,215,000 as of January 1, 2003. Mr. Farina prepared a complete self-contained appraisal report utilizing the three traditional approaches to value for the subject property wherein he estimated the subject's fair market value, subject to the existing HAP contract, of $4,130,000 as of January 1, 2003. In order to examine the positive and negative effects of the governmental agreements on the subject's fair market value, both appraisers valued the subject as if encumbered by the IHDA/HAP agreements and as if unencumbered by the government programs.

Farina, on behalf of the board of review, was the only appraiser to develop a sales comparison approach in estimating the subject's fair market value. He testified that he gave this approach only marginal weight in his final value conclusion because the sale of subsidized properties is rare and his comparables required significant adjustments to make them comparable to the subject. Farina further testified that he agrees with Heilman and would have disregarded the entire sales comparison approach. During cross examination, Farina testified that the sales comparison approach was only included at the request of the client.

Appellant's counsel argued that Farina's credibility is called into question because Farina's sales comparison approach estimated the subject's fair market value at $35,000 per unit or $4,130,000, it exactly matched, to the penny, his estimation of value under the income approach. The inference is that Farina’s credibility was called into question because he manipulated his estimates and calculations to reconcile the two approaches, one of which he gave the most weight and one of which he only gave marginal weight. On the other hand, Heilman also admitted on cross examination that he adjusted his cost approach value to conform to his income approach value.

The Property Tax Appeal Board finds it suspect that an approach which was only given marginal weight, required significant adjustments not detailed within the appraisal, was disregarded as not providing any meaningful information in the subject's final estimate of value, exactly matches the approach most heavily relied upon by Farina, the board of review’s appraiser. Further, the Property Tax Appeal Board finds it problematic that a cost

approach to value is adjusted to conform that value with an estimation of value using the income approach.

Both appraisers utilized the same land sales and found similar values for the subject land under the cost approach. Heilman valued the subject land at $3.45 per square foot or $265,000 while Farina estimated the subject's land value to be $3.50 per square foot or $270,000.

In his cost approach, Heilman utilized the Marshall Valuation Service for Class C construction. The replacement cost was $58.29 per square foot or approximately $4,959,495. He then added a replacement cost for the subject garage of $10,500; elevator of $300,000; and a 10% entrepreneurial profit of $527,006 for a total building replacement cost of $5,797,061. Site improvements of $97,500 and 10% entrepreneurial incentive of $9,750 were added to arrive at a total replacement cost new of $5,904,311.

Heilman estimated physical depreciation of 30% based on the Marshall Valuation Cost Service using the age-life method. Heilman found no functional obsolescence. He then estimated 55% external obsolescence using an income approach fee simple compared to an income approach with a discounted cash flow that included encumbrances of an IHDA mortgage. This was added to the physical depreciation to arrive at a total depreciation for the subject building of 85% or $4,927,502. Site depreciation of $91,163 was added to the building depreciation to arrive at a total depreciation for the subject building and site improvements of $5,018,665. After subtracting the depreciation amounts from the total replacement cost new indicated a total depreciated value of $885,646. Heilman then added the land value of $265,000 which indicated a total replacement cost new for the subject of $1,150,000 rounded.

Farina also utilized the Marshall Valuation Service to estimate the subject's value using the cost approach, however, he utilized the Marshall Valuation Service for Class B construction. The indicated cost was $85.74 per square foot or approximately $7,362,065. A replacement cost for the garage of $11,979 was added to site improvements of $100,000 and a 10% entrepreneurial profit of $747,404 for a total replacement cost of $8,221,449.

Farina estimated physical depreciation of 30% and external obsolescence of 10%. He then found the subject suffered functional obsolescence of 10%. Total depreciation of 50% or $4,110,724 was deducted from the replacement cost new and the estimated land value was added to arrive at a total replacement cost new for the subject of $4,380,000.

The Board finds it problematic that each appraiser used the Marshall Valuation Service for a different class of construction. Heilman utilized Class C (low cost quality of construction) and

Farina utilized Class B (reinforced concrete and average quality construction). Neither party refuted the classification used by the opposing party. However, even though both parties utilized basically the same method under the cost approach to determine the subject's value, this difference alone amounts to $27.45 per square foot or approximately $2,335,532.

Each appraiser differed on the amount of external obsolescence. Heilman estimated the subject depicted external obsolescence of 55% while Farina testified that the subject depicted a modest external obsolescence of 10%. On cross examination, Farina acknowledged that his appraisal indicates the subject suffers from significant external obsolescence of 10% due to the limited number of paved parking spaces. Heilman compared the subject's estimated fee simple value to the subject's estimated value with HUD restrictions to estimate external obsolescence.

The International Association of Assessing Officers defines external obsolescence as:

> Loss in value as a result of an impairment in utility and desirability caused by factors external to the property (outside the property's boundaries) and is generally deemed to be incurable. External obsolescence can be caused by a variety of factors such as changes in the highest and best use of a property due to market shifts or governmental actions, restrictions on income, zoning, neighborhood decline, lack of property demand, and national economic conditions. External influences can cause both land and improvements to lose value.

Property Assessment Valuation, International Association of Assessing Officers, page 155, Second Edition 1996.

The method utilized by Heilman to estimate external obsolescence takes into account the subject's positive and negative aspects as restricted with the IHDA contract and subsidy agreement. The Board finds the method utilized by Heilman to be the best evidence of estimating external obsolescence suffered by the subject considering its current restrictions and further finds his method is commensurate with the definition of external obsolescence as defined above.

Heilman estimated depreciation for the subject of 85% while Farina estimated depreciation for the subject of 50%. In addition, Heilman detailed depreciation of the subject site improvements while Farina's appraisal does not discuss or address in a clear manner whether the subject's site improvements were considered in his depreciation analysis. The appraisers were approximately $1,000,000 apart in the amount of total depreciation suffered by the subject.

The Board finds Farina's cost approach does not adequately account for the negative aspects of the subject's cash flow in his estimation of external obsolescence experienced by the subject. The limited dividend income of $57,837 was enhanced with additional net income from the property's stabilized cash flow. Adding the limited dividend in with the stabilized cash flow skews the earning capacity of the subject. The record depicts the excess income is controlled by the IHDA contract. In addition, the management expenses, which are a part of the effective gross income, become skewed because of the excess cash flow that is being generated. Even though Farina considered the cash flow generated under the HAP program in the first year, in subsequent years he carried it forward and inflated the cash flow by 2.5% for subsequent years. Ms. Carter testified that the subject's income or rent revenue actually received in year one was $700 per month per unit, and has remained unchanged for years two and three. However, Farina increased the rent income 2.5% based on a clause in the HAP contract. Farina admitted on cross-examination that his analysis was overinflated from what was actually received.

In comparing the income approaches to value the Board finds the appraisers were in disagreement on the subject's reversionary value. Heilman estimated the subject's building had a reversionary interest value of $616,201 and Farina estimated the subject's building had a reversionary interest value of $912,988. The primary difference between the two appraisers' income approaches was in the residual capitalization rate. Farina, the board of review's appraiser, used an unloaded residual capitalization rate of 9% while Heilman, the appellant's appraiser, used a loaded capitalization rate of 13.32%. Farina expensed the property taxes as a line item entry in each year of his projections. To do this, Farina used the assessment amount currently under review and increased this tax liability by 3% per year throughout his analysis. Farina admitted that if the subject's tax obligation increased, then that amount, which could be significant, would carry forward and be compounded from year one of his calculations to year fifteen.

The appellant's appraiser used a method commonly used by assessing officials which requires property taxes to be addressed through the inclusion of an effective tax rate as a component of the overall capitalization rate.

> When the income approach is used to determine the property value for tax purposes, the practice of using property taxes as an expense item is based on a preconceived value and discredits the whole approach. Since taxes are often the largest single expense, this practice leaves the final value conclusion subject to considerable error. The problem can be resolved by developing an effective tax rate and by including the rate in the

> capitalization rate for the property being appraised.

Property Assessment Valuation, International Association of Assessing Officers, page 240, Second Edition 1996.

The Board finds the overall capitalization rate estimated by the appellant's appraiser to be better supported within the appraisal and by the principles established by the International Association of Assessing Officers. The Board further finds Heilman's testimony concerning the calculation of the capitalization rate and his discounted cash flow analysis more credible. Heilman's method accurately depicts the subject's income and expenses and takes into account both the positive and negative aspects of the government subsidized housing restrictions.

On the other hand, the Board finds Farina's testimony depicts his income cash flow calculations were over-inflated from actual rents received and not supported in the record. Farina's appraisal assumes the replacement reserve account and the residual receipts account are income to the appellant. However, the record depicts the replacement reserve account can only be used with permission of IHDA for maintenance of the subject. At the end of the government program, any monies left in the replacement reserve account revert to IHDA. The unrefuted record further depicts the residual receipts monies are not considered income of the owner, but rather, revert back to IHDA on termination of the program. Farina included both of these accounts in his estimation of the subject's income. In addition, any errors in Farina's cash flow analysis, which may have occurred in his initial calculations, were compounded in his final estimation of value.

In conclusion, after considering the appraisals submitted by the parties and the testimony of the witnesses, the Property Tax Appeal Board finds that the appraisal and credible testimony provided by the appellant's witness is the best estimate of value in the record. Thus the Board finds the subject property had a market value of $1,215,000 as of January 1, 2003. By stipulation the parties agreed that the assessed value established by the Property Tax Appeal Board for year 2003 should carry forward to the appeals for 2004 and 2005, subject to the applicable township equalization factor. The Boone County Board of Review indicated that no local equalization factors were applied in 2003 and 2004 for commercial properties in Boone County. In 2005 the board of review utilized an equalization factor of 1.015 for commercial property.

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: September 28, 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.