

IN THE COURT OF APPEALS OF IOWA

FILED

DEC 26 1984

CLERK SUPREME COURT

McKINLEY ARMS APARTMENT CO.,

)

Plaintiff/Cross-Appellant,

)

Filed December 26, 1984

vs.

)

4-455
83-356

438

**BOARD OF REVIEW OF THE CITY
OF DES MOINES, IOWA, ET AL.,**

)

Defendants-Appellants.

)

Appeal from the Iowa District Court for Polk County - Anthony M. Critelli,
Judge.

Defendants appeal and plaintiff property owner cross-appeals from the
district court judgment in an appeal from a property tax assessment. **AFFIRMED.**

Allan A. Herrick and William R. Clark, Jr., of Herrick, Langdon & Langdon,
Des Moines, for defendants-appellants.

James E. Brick of Brick, Seckington, Bowers, Swartz & Gentry, P.C., and J.
Riley McManus, Des Moines, for plaintiff-appellee.

Considered by Donielson, P.J., and Hayden and Sackett, JJ.

SACKETT, J.

I. Nature Of The Case

Defendant - Board of Review of the City of Des Moines, assessed the value of plaintiff - McKinley Arms Apartments, property for the purpose of determining real estate tax amounts. Plaintiff filed a protest to a January 1, 1981 assessment which set the value of the property at \$1,428,020.00. The Board of Review denied plaintiff's protest. After trial on the merits, the district court determined that the assessment was excessive and granted a reduction of \$128,020.00. The defendant filed an appeal from the district court judgment which fixed the value of plaintiff's property at \$1,300,000.00. On appeal, defendant asserts that: (1) the evidence failed to establish that the assessment was excessive; (2) under Iowa Code section 441.21 the district court should not have found that certain adjustments should have been made by defendant's experts in order to justify their valuation based on a market value approach.

II. Statement Of The Facts

Plaintiff is the owner of an apartment complex located on Southwest Ninth Street and commonly referred to as McKinley Arms Apartments. The complex consists of three buildings housing 84 units total - 24 efficiency, 36 one-bedroom and 24 two-bedroom apartments. The complex offers a swimming pool, 24 garage units and a paved parking lot capable of accommodating 180 automobiles. Each apartment is furnished with a refrigerator, stove, air conditioning and garbage disposal. The complex also furnishes hot water and gas heat at the landlord's expense.

As required by Iowa statute, the plaintiff produced two expert witnesses who offered testimony and documents to suggest that the assessor's valuation was excessive. See Iowa Code §441.21(3)(1983).

A. Mr. Margolin.

The first appraisal witness to testify on behalf of the plaintiff was Albert

Margolin, a real estate appraiser with an office located in Kansas City, Missouri. Mr. Margolin possesses a B.S. in business administration from Washington University, a J.D. from the University of Missouri at Kansas City, and had been an appraiser for some twenty-six (26) years. Margolin testified to the fact that he considered all three of the customary approaches utilized by appraisers in attempting to evaluate the worth of a piece of property, namely, the market data (sales prices) approach, the income approach and the replacement cost approach.

Upon a consideration of the market approach, Margolin could find no appropriate, comparable cash - or close to cash - sale transaction for real estate occurring in the Des Moines area so as to give him an idea of the fair and reasonable value of the subject property on the open market. He did find some comparable property which had been sold on contract. In order to determine the fair and reasonable market value of this property he attempted to calculate a so-called "cash equivalency." In calculating cash equivalency a contract sale transaction is divided into the price the buyer paid for the property and the price paid for the financing required. He did attempt to arrive at a valuation using the market approach, but concluded that too many adjustments had to be figured into the calculations so as to render a conclusion unuseable.

Margolin also calculated a value for the McKinley Arms Apartments using the replacement cost method. He began this analysis with a floor space of 59,400 square feet. Employing what he described as the Marshall Valuation Service, he calculated a cost to replace at \$23.10 per square foot. Figuring in "multipliers for a perimeter and certain changes in the property and for location and time" he arrived at a valuation of \$1,314,900. This figure presumes a replacement cost, new, if built on January 1, 1981. Subtracting physical depreciation, the cost would be \$736,344, according to Mr. Margolin. Finally, Margolin gave consideration to economic depreciation - four factors "outside" the subject property, e.g., busy access street, excessive noise, etc. - and functional depreciation - because of run-

off water entering the basement apartments. Subtracting these two amounts, and adding back the value of land value where the complex was situated, the cost approach yielded a valuation figure of \$823,447. He opined that the cost approach would yield an absolute ceiling on the value of the property.

The third valuation method considered by Mr. Margolin was the income approach. Using three alternative solutions to this approach, he came up with a final valuation of \$697,672, which he rounded to a final figure of \$698,000.

B. Mr. Richards.

The next appraisal witness called by the plaintiff was a man by the name of Tom Richards. Mr. Richards testified that he was a professional real estate appraiser with 37 years of experience. He too gave consideration to the three (3) approaches to real estate valuation. Richards was questioned as to whether he had an opinion on the value of the McKinley Arms Apartments using the market value approach. He stated that there were "too many variables" and "too much erraticism" in performing the necessary adjustments to contract sales without a lot of error occurring. He did not have an opinion using this approach.

Richards utilized the income stream and cost methods in order to calculate a valuation for the subject property. As to the income stream approach, he calculated the cash flow of the apartment complex and applied a capitalization rate of .18 to come up with a rounded valuation figure of \$782,500. As for the cost approach, Richards estimated that there was 58,320 square feet of floor space in the three buildings comprising the subject complex. From a reliable source he estimated it would cost \$22.50 per square foot of space. Adding to this the cost of improvements and equipment, Richards calculated a total valuation of \$1,526,034 using the replacement cost method. After arriving at a figure using these two approaches, Mr. Richards testified that his final estimate of the fair market value of the McKinley Arms Apartments was \$847,500 as of January 1, 1981.

C. Mr. Winegar.

The defendant also produced two expert appraisal witnesses. The first was Mr. Harold A. Winegar, president and senior member of Winegar-Johnson Appraisal Company located in Des Moines. Mr. Winegar had an opinion pursuant to all three methods of valuation. He defined the different approaches before rendering his opinions. He viewed the cost approach as basically an estimation of the value of improvements made to real estate, less depreciation, plus the value of the land itself. The income approach was described as estimating economic rent, deducting vacancies, deducting allowable operating expenses, arriving at a net income, and then capitalizing the income into the valuation figure. As for the market approach, Mr. Winegar stated that the market place must be researched to find out if there are any sales of similar properties. If there are and such sales are comparable, they can be used to determine a gross rent multiplier or a sales price per apartment unit.

Mr. Winegar was able to formulate an opinion on valuation using all three of the valuation methods. Employing the cost method, he multiplied a replacement cost per square foot by the total square footage of the complex to arrive at a current replacement cost of \$1,528,956. Applying a factor of .20 to cover physical, fractional and economic depreciation, plus certain other depreciation deductions, Mr. Winegar calculated the value of McKinley Arms Apartments as of January 1, 1981 to be \$1,528,000. Using an overall capitalization rate of .1235, and applying this to net income, he arrived at a valuation of \$1,328,000, using the income approach.

Winegar testified that he was able to use the market approach to valuation in this instance, claiming that he had found four comparable properties. He analyzed the gross rent multiplier at the time of sale and the sales price per unit to arrive at a gross rent multiplier of 6.5 for plaintiff's property for a value of

\$1,506,960. Likewise, he determined a price per unit of \$17,850, for a total valuation of \$1,499,400 for the 84 units which make up the McKinley Arms Apartments. Mr. Winegar's final estimated valuation of the subject property was \$1,500,000.

D. Mr. Stewart.

Defendant's second appraisal witness was Willard A. Stewart, president of a Cedar Rapids real estate appraisal company, a gentleman with 35 years of experience as a real estate appraiser. Like Mr. Wingar, Stewart was able to arrive at a valuation using all three methods. Concerning replacement cost, he estimated the cost to replace new would be \$1,593,000. Adjusting this figure so as to account for depreciation, the valuation became \$1,465,000. In calculating this amount he used a depreciation rate of .25 for the improvements made on the realty.

Using the income approach, Mr. Stewart arrived at a valuation of \$1,234,300. He used a capitalization rate of .141 on net income for improvements of \$144,432. Adding back the \$210,000 value of the land where the complex is situated, he was able to arrive at a valuation calculation.

Using the market approach, Mr. Stewart found three comparable sales. He did not make any adjustments for the fact that they were made on contract as he felt that such sales were normal and did not require adjustment. His opinion as to the value of the McKinley Arms Apartments using this approach was \$1,680,000. His final opinion as to valuation of the subject property was \$1,548,000.

The conclusions of the four expert appraisers are summarized (in dollars) as follows:

	<u>Market Approach</u>	<u>Cost Approach</u>	<u>Income Approach</u>	<u>Final Opinion as to Valuation</u>
Margolin	not utilized	823,447	690,000	690,000
Richards	not utilized	912,574	782,500	847,000
Winegar	1,500,000	1,548,000	1,328,000	1,450,000
Stewart	1,680,000	1,465,000	1,234,000	1,548,000

III. Applicable Law.

A. Scope of Review.

As we are the court to consider this appeal, we hear this matter in equity and the issues before the board of assessment are triable anew. Iowa Code §441.39 (1983). We consider all the evidence and there is no presumption as to the correctness of the valuation of assessment appealed from. Id. As this is an equitable matter, review of the district court decision by this court is de novo. Iowa R. of App. P. 4 (1983). While we are not bound by the findings of the trial court, we do give them weight; Iowa R. of App. P. 14(f)(7)(1983); especially where the credibility of witnesses is involved. Id.

B. Substantive Law.

Iowa law requires that an assessment for property tax purposes be made at the fair market value or the actual value of the subject realty.

All real and tangible personal property subject to taxation shall be valued at its actual value. . . and . . . shall be assessed at one hundred percent of its actual value, and the value so assessed shall be taken and considered as the assessed value and taxable value of the property upon which the levy shall be made.

Iowa Code §441.21(1)(a)(1983).

The actual value of all property subject to assessment and taxation shall be the fair and reasonable market value of such property except as otherwise provided in this section. "Market value" is defined as the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each being familiar with all the facts relating to the particular property. Sale prices of the property or comparable property in normal transactions reflecting market value, and the probable availability or unavailability of persons interested in purchasing the property, shall be taken into consideration in arriving at its market value. In arriving at market value, sale prices of property in abnormal transactions not reflecting market value shall not be taken into account, or shall be adjusted to eliminate the effect of factors which distort market value, including but not limited to sales to immediate family of the seller, foreclosure or other forced sales, contract sales, discounted purchase transactions or purchase of adjoining land or other land to be operated as a unit.

Iowa Code §441.21(1)(b)(1983).

When a taxpayer challenges an assessment as excessive, inadequate, inequitable or capricious, the taxpayer has the burden of proof. However, if the taxpayer "offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor, the burden of proof thereafter shall be upon the officials or persons seeking to uphold such valuation to be assessed." Iowa Code §441.21(3)(1983). In this case, plaintiff offered competent evidence by two disinterested appraisers that the assessed value was excessive. Therefore, the burden of proof shifted to defendant to uphold the assessment. See id.

As shown above, Chapter 441 requires that property be assessed at its "actual value" and defines actual value as market value. Iowa Code 441.21(a)(1983). This chapter also sets criteria for determining how market value shall be established. Iowa Code §441.21(1)(b)(1983). Section 441.21 provides two approaches for ascertaining market value - the "sales prices" approach and the "other factors" approach. Equitable Life Insurance Co. v. Board of Review, 281 N.W.2d 821, 823 (Iowa 1979). The sales prices approach depends on the availability of sales prices of the subject property or comparable property in normal transactions. Id.; Iowa Code §441.21(1)(b)(1983). If the market approach, the market value of the subject property cannot be readily established by the sales prices approach, then the other factors approach is to be used. Equitable Life, 281 N.W.2d at 323; see also Milroy v. Board of Review of County of Benton, 226 N.W.2d 814, 819 (Iowa 1975).

In the instant case, five appraisal witnesses testified. Tom Richards and Albert Margolin testified on behalf of the plaintiff and opined that the actual value of plaintiff's property was less than its assessed value as of January 1, 1981. Three witnesses testified on behalf of the defendant, Harry Winegar, Willard Stewart and M. E. Horman, Chief Deputy Assessor for the City of Des Moines. All of the defendant's witnesses supported the valuation placed on plaintiff's property by the assessor and affirmed by the defendant.

Each of the four expert appraisal witnesses testified that they considered three traditional approaches to valuation of real property - the income approach, replacement cost approach and market data (sales prices) approach. Both of plaintiff's witnesses, Margolin and Richards, testified they couldn't use the market data approach because their respective reviews of available sales data indicated that there were too many variables and adjustments to be made, which left too much room for error in making an accurate valuation. Defendant argues that its experts should be believed because they used both the sales prices and other factors approaches whereas plaintiff's experts rejected the sales prices approach.

Chapter 441 of the Iowa Code provides in part:

In arriving at market value, sales prices of property in abnormal transactions not reflecting market value shall not be taken into account, or shall be adjusted to eliminate the effect of factors which distort market value, including but not limited to sales to immediate family of the seller, foreclosure or other forced sales, contract sales, discounted purchase transactions or purchase of adjoining land or other land to be operated as a unit. (emphasis added)

Iowa Code §441.21(1)(b)(1983). The supreme court has also recognized that contract sales prices should be adjusted to reflect the market value of property. Foreman & Clark of Iowa, Inc. v. Board of Review, 286 N.W.2d 169, 172-73 (Iowa 1979). In Redfield v. Iowa State Highway Commission, 252 Iowa 1256, 110 N.W.2d 397 (1961) the supreme court stated that a cash sale reflects market value and, further, that a contract sale may reveal a speculative value such that it would not be reflective of the required market value. Id. at 1262-63, 110 N.W.2d at 401. The court went on to explain:

While we have above announced the principle that sales on contract in which part of the purchase price is to be paid in deferred installments are not necessarily to be excluded as not having any relation to fair cash market value, we think this is a rule which should be applied with considerable care. Many considerations enter into deferred payment sales which are not present when cash must be paid. The American people are

characteristically users of credit; homes, automobiles, and household appliances and furniture are sold daily on long-term credits with installment payments; and it is common knowledge that these purchases eventually cost the buyer more than if he could provide the cash. On the other hand, there are tax questions sometimes involved which make the vendor prefer to secure his money in several yearly payments rather than in a lump sum which might involve him with the capital gains tax or other governmental mulctings.

Id. at 1265, 110 N.W.2d at 402-03.

Albert Margolin, plaintiff's first expert appraisal witness, testified that he did not use the market (sales prices) approach. He did not find sales that were not either contract sales or carry-back mortgages at interest rates which were way below the market rate for money which was 16 percent. He could find them at 9 percent and 9 and 1/2 percent and 10 and found one sale that was an interest only with another payment on principal at a variable rate from 9 and 1/4 to, he thought, 10 and 3/4, but could find no sales at 16 percent interest or even 15 percent interest, which is what the market rate for money was at that time. Plaintiff's second appraisal expert, Tom Richards, testified that he did not use the sales prices appraisal, as all he found were contract sales for comparable properties. He felt there were too many variables, too much erraticism to property adjustment - creating too much room for error.

Both of defendant's expert appraisers used unadjusted contract sales as comparable sales to arrive at a market value under the sales prices approach. Harry Winegar made no adjustments even to a seven-year contract sale calling for a balloon payment at the end of each year to take advantage of variable interest rates. He did not feel it was necessary to adjust the sales values because contract sales with large down payments were equivalent to cash sales. Winegar would have used the unadjusted contract sale of Eastridge Apartments as a comparable sale price even though it sold for only \$125,000 down. City Assessor M. E. Harmon testified that Eastridge Apartments sold in 1980 for \$1,200,000, with slightly more than ten percent down. Earlier, Winegar stated he'd require 25% down in order to have a cash equivalency.

Willard A. Stewart also testified that he did not make any adjustments to the contract sales although he admitted that when he worked for the Department of Revenue contract sales were not used whether they were adjusted or not.

We believe the trial court was correct not to follow a valuation reached based on unadjusted contract sales. The Code and caselaw warn that such sales must be carefully examined to ensure they reflect the market value of the subject property. Iowa Code §441.21(1)(b)(1983); Redfield v. Iowa State Highway Commission, 252 Iowa 1256, 110 N.W.2d 397 (1961). In addition, Harry Winegar's credibility was questionable on this issue of valuation. He used a figure of \$1.65 per square foot in arriving at a land value for the land on which the complex is built. This is 10 cents higher than the highest comparable used and 55 cents more than the average of four comparable properties. This is so, even though Winegar was aware of water drainage problems which McKinley Arms experienced, and no evidence was produced to suggest that similar problems plagued the comparables. He also stated that two comparable sales were cash sales when in fact they were sales involving some money down with an assumable mortgage, clearly not a cash sale.

Defendant submits that the testimony of its witnesses is more credible than that of the plaintiff's. As we have mentioned earlier, the trial court is in a better position to test the credibility of witnesses than we are. We will give weight to the trial court's decision as to credibility even in a de novo review. Iowa R. of App. P. 14(f)(7)(1983). We note, however, the defendant's witnesses have used almost straight line depreciation when viewing valuation from the cost approach. This is so, even though evidence introduced at trial suggested that the subject property suffered from water seepage problems due to drainage to the site from three directions. We find that there are enough problems associated with the buildings because of this happenstance to warrant a higher depreciation factor.

Under the income approach, the main variance among the appraisers was the

capitalization rate. The trial court found a rate of .15 was the most credible. We do not dispute this conclusion. This rate was between the extremes of .18 and .1235 and was very close to the fourth expert's opinion of .141. The district court valued the improvements at \$1,090,000, and property at \$210,000. After de novo review, the decision of the trial court is affirmed.

AFFIRMED.