COURT OF APPEALS DECISION DATED AND RELEASED

JANUARY 14, 1997

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* § 808.10 and RULE 809.62(1), STATS.

NOTICE

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No. 96-2216-FT

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT III

RHINELANDER FAMILY HOUSING, A DOMESTIC LIMITED PARTNERSHIP,

Plaintiff-Appellant,

v.

CITY OF RHINELANDER BOARD OF REVIEW,

Defendant-Respondent.

APPEAL from a judgment of the circuit court for Oneida County: ROBERT E. KINNEY, Judge. *Affirmed.*

Before Cane, P.J., LaRocque and Myse, JJ.

PER CURIAM. Rhinelander Family Housing, a partnership, appeals a judgment affirming the City of Rhinelander Board of Review's tax assessment.[1] Rhinelander Family Housing argues that the assessment violates ***Metropolitan Holding Co. v. Board of Review***, 173 Wis.2d 626, 495 N.W.2d 314 (1993), which requires the tax assessor to take account of federal rental income

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[1] This is an expedited appeal under RULE 809.17, STATS.

restrictions when determining fair market value of subsidized rent restricted housing. Because Rhinelander Family Housing failed to meet its burden to show that the assessment was not made according to law, we affirm the judgment.

1. Facts

The underlying facts are not disputed.[2] Westridge Village, built in 1991, is a thirty-two unit income restricted federally subsidized apartment complex. Its purpose is to provide affordable housing for low income and elderly persons in rural areas. The Farmers Home Administration (FmHA) provides financial assistance in the form of an interest subsidy. In return for a financing package that includes a fifty-year loan for 95% of the construction cost at one percent,[3] the apartment complex is restricted to a maximum of 8% return on its initial investment and must provide FmHA approved below marked rental rates for the duration of the loan. Rhinelander Family Housing claims to have received 36% less income than would an owner of a building who charges market rental rates. It is undisputed that absent the federal subsidy, the property would not have been built at its present location.

For the 1993 tax year, the board adopted the city assessor's determination of value. The assessor used a cost less depreciation method resulting in a $1,081,400 assessment, consisting of $50,000 for land and $1,031,400 for improvements. Rhinelander Family Housing challenged the assessment in circuit court, and the court remanded to the board to revalue the property. Shortly thereafter, the city assessor reduced the assessed value of Westridge Village to $960,000; $50,000 was attributed to the land and $910,000 to improvements. Rhinelander Family Housing challenged this assessment before the board, and the board upheld the $960,000 valuation for tax years 1993 and 1994. Rhinelander Family Housing challenged the board's decision in

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[2] To support its statement of facts, Rhinelander Family Housing's appellate brief cites to R20, the City of Rhinelander Board of Review's trial brief in opposition to a writ of certiorari. City of Rhinelander Board of Review's response brief does not contain any citation to the record, but cites pages A25 and A26 of its appendix. These are two pages of a transcript dated September 12, 1994. Because we must review the record before the board, it would be helpful to cite directly to the record. *See* ***Keplin v. Hardware Mut. Cas. Co***, 24 Wis.2d 319, 324, 129 N.W.2d 321, 323 (1964).

[3] The parties do not agree whether the loan was for 95% or 97% of the cost of construction.

circuit court, which affirmed the assessment. Rhinelander Family Housing appeals the circuit court's judgment.

At the hearing before the board, Rhinelander Family Housing relied on the expert testimony of Albert Gay, a real estate appraiser. Gay testified that for income property such as Westridge Village, the income approach was the most reliable method to estimate fair market value. Using various capitalization rates as applied against the income, he determined an appraised value of $500,000. In general, the higher the capitalization rate, the lower the indicated value.

Both Gay and the city assessor agreed that the limited number of comparable sales prevented a reliable market sales comparison. Nonetheless, using the market approach and three comparable sales in Waupun, Crandon and Twin Lakes, Gay made cash equivalency adjustments and reached an estimated value of $500,000. Gay qualified his opinion by stating that there has not been sufficient numbers of comparable sales in the state to put any degree of importance on a market approach.

Next, using a cost approach, and a replacement cost of $1,032,487, minus a factor for physical, functional and economic obsolescence, Gay obtained an appraised value of $465,400. Taking all three approaches into consideration, Gay concluded the property's fair market value as of January 1, 1994 was $500,000.

Next, the board heard opinions from two additional witnesses. Mike Muelver, city assessor, agreed that the comparable sales valuation method would be unreliable to value the subject property due to insufficient data. Muelver testified that he had retained appraiser Kyle Zastrow to analyze the information provided to the board and to review Gay's opinions, but not to conduct a full appraisal of the property. Zastrow reviewed the cost, income and market approaches with information provided by the city assessor and Gay's appraisal. Because the property was investment property, Zastrow also compared it to an annuity.

Muelver and Zastrow disagreed with Gay's valuation methods and conclusions. For example, Zastrow concluded that Gay utilized an erroneous capitalization rate in his income approach. Zastrow believed that because actual restricted rent rates were used, the government subsidized 1% interest rate should be a component of capitalization rate calculation. Gay, on the other hand, had testified that the mortgage face value of 8.75% was appropriate.

Based on a variety of factors, Muelver and Zastrow concluded that $960,000 was the correct value. After the hearing, the board set the assessments for 1993 and 1994 at $960,000. Rhinelander Family Housing appealed the assessments to the circuit court, which upheld the board's decision. Rhinelander Family Housing appeals the judgment.

2. Standard of Review

On certiorari review of a property tax assessment, we are bound by the record before the board, but not by the trial court's conclusions. ***State ex rel. Wis. Power Co. v. Board of Armenia,*** 125 Wis.2d 94, 97, 370 N.W.2d 580, 582 (Ct. App. 1985). Our scope of review is limited to determining whether (1) the board acted within its jurisdiction; (2) it acted according to law; (3) its action was arbitrary, oppressive or unreasonable; and (4) the evidence is such that the board might reasonably make the determination it did. ***Waste Mgmt. v. Kenosha County Bd. of Review,*** 184 N.W.2d 541, 554, 516 N.W.2d 695, 701 (1994).

If there is a conflict in the testimony respecting the value of the property, the court does not substitute its opinion of the value for that of the board. ***Rosen v. City of Milwaukee***, 72 Wis.2d 653, 662, 242 N.W.2d 681, 684 (1976). If there is credible evidence before the board that may in any reasonable view support the assessor's valuation, that valuation must be upheld. ***Id***. If the assessment is made according to the statutory mandate, it must be upheld if it can be supported by any reasonable view of the evidence. ***Waste Mgmt***., 184 Wis.2d at 555, 516 N.W.2d at 701.

3. Tax Assessment Law

Section 70.32(1), STATS., governs the valuation of real property and requires an assessor to value real property "in the manner specified in the Wisconsin property assessment manual" from actual view or the best information available. It must be valued at the "full value" which could be ordinarily obtained at a private sale. ***Metropolitan Holding***, 173 Wis.2d at 631, 495 N.W.2d at 316. "Full value" is defined as fair market value or the amount obtainable in an arm's length transaction on the open market. ***Waste Mgmt.***, 184 Wis.2d at 556, 516 N.W.2d at 701. The burden is on the challenger to overcome the presumption that the assessor's valuation is correct. ***Rosen,*** 72 Wis.2d at 662, 242 N.W.2d at 684.

"[I]n the absence of a sale of the property in question the sale of 'reasonably comparable' property provides the 'best information' of market value." ***Id***. at 665, 242 N.W.2d at 686. Here, there was no direct sale of the property, and the parties agreed that there were insufficient comparable sales to provide reliable data. Where there are no comparable sales, the assessor may consider all the factors that according to professionally acceptable appraisal practices have a bearing on the value, including costs, depreciation, replacement value and income. ***Id***. at 663, 242 N.W.2d at 685. Net income may never be the sole basis for a property valuation, but may be considered along with other factors. ***Waste Mgmt***., 184 Wis.2d at 558, 516 N.W.2d at 702.

1 WISCONSIN PROPERTY ASSESSMENT MANUAL 9-27 (1997) cautions against using the cost approach to value federally subsidized housing, as do other state courts.

> The great dilemma in assessing federally assisted housing projects is that the "value" of these projects is inherently ambiguous. Construction costs are known; but these overstate the market value of the project, since in the absence of subsidy the rental stream produced by the property would not justify the actual expenditure on construction.

Congresshills Apts. v. Township of Ypsilanti, 341 N.W.2d 121, 124 (Mich. App. 1983) (quoting ***Community Dev. Co. v. Board of Assessors***, 385 N.E.2d 1376, 1378 (Mass. 1979)).

Faced with this dilemma, both experts relied heavily on the income approach. Using a net income approach, an assessor converts future benefits likely to be derived from real estate into an estimate of present value.

Waste Mgmt., 184 Wis.2d at 561, 516 N.W.2d at 703. "The income approach is often the most useful and often the only method for valuing subsidized housing because of the conditions of the agreement and the limited availability of data." 1 WISCONSIN PROPERTY ASSESSMENT MANUAL 9-27 (1997).

The basic mechanics of the income approach are as follows:

> An assessor first determines the net annual income of the property. This figure is reached by deducting estimated operating expenses from the property's gross income. The assessor also selects a capitalization rate by considering the discount and recapture rates suitable for such investment as well as the applicable effective tax rate. Finally, the assessor applies a capitalization rate to the net annual income to yield the present value of the expected income stream over the life of the property.

Waste Mgmt., 184 Wis.2d at 561, 516 N.W.2d at 703-04.

The WISCONSIN PROPERTY ASSESSMENT MANUAL expresses this method as a formula: Income/capitalization rate = value. ***Id***. at 7-20. "[N]o formula, however, can be any more accurate than the variables upon which it relies." ***Tradewinds East Ass'n v. Hampton Ch. Tp.***, 406 N.W.2d 845, 851 (Mich. App. 1987).

The focus of the debate here is the methodologies used to arrive at the formula's two components, income and the capitalization rate. To calculate net operating income to value federally funded rent restricted housing, actual rental rates, not estimated market rates are to be used. ***Metropolitan Holding***, 173 Wis.2d at 632, 495 N.W.2d at 317. It is error to calculate annual income based on estimated market rents and expenses: The "use of estimated market rents violated sec. 70.32(1), because the estimated market rents did not reflect the true market value of Layton Garden." ***Id.*** at 631-32, 495 N.W.2d at 317.

Also, selecting an appropriate capitalization rate is critical and "[d]etermining this rate is the most difficult factor in determining valuation under the capitalization-of-income approach." ***Dowagiac Ltd. Dividend Housing Ass'n v. Dowagiac,*** 420 N.W.2d 114, 118 (Mich. App. 1987). Therefore, we first address the capitalization rate.

4. Calculation of the Capitalization Rate

Rhinelander Family Housing challenges the capitalization rate utilized by Zastrow and the city assessor. Because Rhinelander Family Housing's argument is brief, we quote it in its entirety:

> Mr. Zastrow incorrectly applied the band-of-investment method when performing the income approach to valuation. When computing his capitalization rate through this approach, Mr. Zastrow utilized a debt component of 1%, presumably employing the Note rate, less the payments made to the lender by the government under the FmHA §515 program. The debt component must, however, utilize the actual mortgage rate, or 8.75%. Mr. Zastrow erroneously assigned the "value" of the subsidized mortgage to the owner, rather than to the tenants. If one were to use the actual mortgage rate as a component of the band of investment analysis, one would arrive at a value approximately that employed by Mr. Gay, or $422,232.58. ($72624/.0172).

Rhinelander Family Housing's briefs suggest that ***Metropolitan Housing*** controls this issue. ***Metropolitan Housing,*** however, concerned itself solely with the calculation of net operating income, not with the determination of the second half of the fraction, the capitalization rate. Because ***Metropolitan Housing*** did not address the determination of a capitalization rate, it serves as guidance only in the general sense that it requires the use of actual rental income and actual expenses in the valuation process.

The WISCONSIN PROPERTY ASSESSMENT MANUAL addresses the calculation of capitalization rates for income properties generally, but not government subsidized housing specifically. The manual advises that the capitalization rate is composed of a number of elements, including: (1) the discount rate, defined as the rate of return required by investors to compensate for the risk assumed, the non-liquidity of their investment and the use of their money; (2) the recapture rate, defined as the annual rate of return which will provide the investor with a return of the depreciable portion of the investment over the remaining economic life of the asset; and (3) the effective tax rate. 1 WISCONSIN PROPERTY ASSESSMENT MANUAL 9-13, 14 (1997).

The manual suggests the use of market interest rates, rather than the face value of the instrument in question, in the calculation of capitalization rates, but this position is advanced by neither party.[4] Without an exhaustive discussion of the variety of methods to determine capitalization rates, we

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[4] The manual refers the reader to its chapter on commercial valuation for a more detailed explanation of capitalization rate calculation. That chapter discusses a variety of methods, including the mortgage-equity method:

> This method is based on the premise that an overall rate can be developed through a knowledge of the mortgage and equity requirements of property purchase. Its simplest application is a band of investment method. The assessor needs to know what percent of value the lending institutions require as a downpayment, or equity from investors. The assessor also needs to know the interest rate required or mortgages by lending institutions, and the yield rate required on the equity by investors. Much of this information can be obtained from lending institutions. The balance may be gathered from discussions with investors, brokers, appraisers, and studies of sales.
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> The band of investments method involves multiplying the mortgage percent of property value times the mortgage constant. The mortgage constant is a percentage which represents the total annual debt service (interest plus amortization of the loan). To this is added the equity percent of the property times the equity interest rate required by investors.
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> ....
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> There are more sophisticated methods of mortgage-equity capitalization which take into account additional factors. ... Explanation of this method is too complex for this manual. If the assessor is interested, there are books or courses available to further explore this method.

1 WISCONSIN PROPERTY ASSESSMENT MANUAL 9-16, 18 (1997).

conclude that the assessment manual provides no direct support for Rhinelander Family Housing's argument. The manual does not directly address the issue whether the face value of the instrument, rather than the government interest rate, should be a component of the capitalization rate calculation. In any event, the legislature intended the manual to conform to, rather than establish, Wisconsin law. ***Metropolitan Holding,*** 173 Wis.2d at 633, 495 N.W.2d at 317. We find, however, no specific legislative guidance on the question before us. We conclude that the manual provides no authority for Rhinelander's claim that the assessment is not according to law.

We conclude that the basic principles of law apply to the valuation of federally subsidized housing complexes in the same manner as they apply to valuation of other property. As one jurisdiction has observed:

> An overriding theme in the decisions addressing the ad valorem taxation of federally subsidized real property is that the valuation process must consider both the positive and negative aspects of the regulatory agreement voluntarily entered into between the owner and government. This comports with the well-established rule that all factors relevant to property value should be considered in the assessment process.

Meadowlanes Ltd. Dividend Housing Ass'n v. City of Holland, 473 N.W.2d 636, 649 (Mich. 1991).[5]

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[5] In ***Meadowlanes Ltd. Dividend Housing Ass'n v. City of Holland***, 473 N.W.2d 636, 647-48 (Mich. 1991), the Michigan Supreme Court stated:

> [A]lthough the mortgage-interest subsidy is an intangible, and not taxable in and of itself, it is a value-influencing factor. In Antisdale, supra at 284, 362 N.W.2d 632, we recognized that without the subsidy these types of properties would not exist. Therefore, the value of the subsidy, if any, should be reflected in the assessment process. ... [T]he subsidy is not taxed in and of itself. ... The interest subsidy reduces the property's total operating costs and adds value by increasing the amount of debt the property can carry.

Rhinelander fails to demonstrate that the board did not act according to law by accepting Zastrow's testimony in support of the assessment. Here, both the city assessor and Zastrow used information provided by the taxpayer to value the property using the income approach. Zastrow explained that he used the government subsidized 1% interest figure in calculating the capitalization rate for the income approach because "if you're using actual rents and actual expenses, then you use actual rates." Because the property was investment property, Zastrow also compared the property to an annuity, a method of valuation specifically suggested by the manual. 1 WISCONSIN PROPERTY ASSESSMENT MANUAL 9-18 (1997). The annuity method supported his conclusions. Rhinelander Family Housing has offered no legal authority that the board's acceptance of this methodology was an error of law. We conclude that Rhinelander Family Housing has not met its burden to demonstrate that the board erred as a matter of law by accepting Zastrow's opinions that included valuation through an income approach that utilized a subsidized 1% mortgage rate in its calculations.

5. Calculation of Net Operating Income

Rhinelander Family Housing also suggests that because the tax assessor failed to consider federal rent restrictions, the assessments for 1993 and 1994 were not set according to law. We conclude that the record fails to support this claim.

Rhinelander Family Housing fails to demonstrate that the assessment violates ***Metropolitan Holding***'s requirement that actual rents be considered. The city's expert witness, Zastrow, used the figure of $72,624 to represent net operating income. He testified that he arrived at this figure using actual, not market rents. Rhinelander Family Housing's expert, Gay, also used the sum of $72,624 to represent net operating income at his first appearance before the board. At the second hearing, Gay used the sum of $69,395 to represent net operating income. Nonetheless, the record fails to show that Zastrow used actual market rents when calculating net operating income. Because the witnesses used different anticipated vacancy rates, the board could infer that different vacancy rates accounted for the relatively minor discrepancy in net income. Consequently, the record fails to demonstrate that the assessor used actual market rents when determining net operating income to calculate value by the income approach to valuation.

6. Conclusion

Because Rhinelander failed to demonstrate that the income approach used by Zastrow and the city assessor was not according to law, the board had before it credible evidence to support its assessment. If there is credible evidence before the board that in any reasonable view supports the assessor's valuation, that valuation must be upheld. ***Rosen***, 72 Wis.2d at 662, 242 N.W.2d at 684. This issue is dispositive, and therefore we do not reach Rhinelander Family Housing's other arguments.

By the Court.—Judgment affirmed.

This opinion will not be published. *See* RULE 809.23(1)(b)5, STATS.