

STATE OF MINNESOTA  
COUNTY OF SCOTT

TAX COURT  
FIRST JUDICIAL DISTRICT  
REGULAR DIVISION

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200 Levee Drive LLLP,  
Petitioner,

**FINDINGS OF FACT,  
CONCLUSIONS OF LAW and  
ORDER FOR JUDGMENT**

vs.

File Nos. 70-CV-07-9031  
70-CV-06-9041

County of Scott,

Dated: April 16, 2008

Respondent.

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The Honorable Sheryl A. Ramstad, Judge of the Minnesota Tax Court, heard this matter on February 5, 2008, at the Scott County Courthouse in Shakopee, Minnesota.

Richard G. Jensen, Attorney at Law, Fabyanske, Westra & Hart, represented the Petitioner.

Jeanne Andersen, Assistant Scott County Attorney represented the Respondent.

Both parties submitted post trial briefs. This matter was submitted to the Court for decision on March 12, 2008.

The Court, having heard and considered the evidence adduced at the hearing, and upon all of the files, records and proceedings herein, now makes the following:

## **FINDINGS OF FACT**

1. 200 Levee Drive LLP (“Petitioner”) has sufficient interest in the property to maintain this petition; all statutory and jurisdictional requirements have been complied with, and the Court has jurisdiction over the subject matter of the action and the parties hereto.
2. The property is a six-story apartment building located in the City of Shakopee, County of Scott (“Subject Property”). The building contains 66 one-bedroom units, an administrative office area, an outside terrace area, a community room, library, exercise room, laundry facilities, and a tub room. There are 21 parking spaces for the building.
3. The Subject Property qualifies as low-income rental housing, as defined by Minn. Stat. § 273.13, subd. 25(e).
4. The Subject Property is zoned B-3, Central Business District.
5. The structure on the Subject Property was permitted through the use of a conditional use permit and as such, it is a legal, conforming use for the property in that zone.
6. The highest and best use of the Subject Property as improved is as a subsidized senior housing property.
7. The Scott County Assessor placed a January 2, 2005 estimated market value of \$2,570,000 and a January 2, 2006 estimated market value of \$3,223,400 on the Subject Property.

8. Petitioner's expert witness, Steven Hosch, MAI, testified that the Subject Property had a January 2, 2005 value of \$1.1 million and a January 2, 2006 value of \$1.19 million.

9. Respondent's expert witness, Terence Chacka, a certified and licensed assessor for Scott County, testified that the Subject Property had a January 2, 2005 value of \$3.3 million and a January 2, 2006 value of \$3.3 million.

### **CONCLUSIONS OF LAW**

1. The assessor's estimated market value for the Subject Property as of January 2, 2005, shall be increased on the books and records of Scott County from \$2,570,000 to \$3,300,000.
2. The assessor's estimated market value for the Subject Property as of January 2, 2006, shall be increased on the books and records of Scott County from \$3,223,400 to \$3,300,000.

LET JUDGMENT BE ENTERED ACCORDINGLY. A STAY OF FIFTEEN DAYS IS HEREBY ORDERED. THIS IS A FINAL ORDER.



BY THE COURT,

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Sheryl A. Ramstad, Judge  
MINNESOTA TAX COURT

DATED: April 16, 2008

### **Memorandum**

At issue in these property tax appeals is the market value of 200 Levee Drive Apartments (“Petitioner”), located at 200 Levee Drive, Shakopee, Minnesota, for the assessment dates January 2, 2005, and January 2, 2006. The Scott County (“County”) Assessor placed a January 2, 2005 estimated market value on the Subject Property of \$2,570,000 and a January 2, 2006 estimated market value on the Subject Property of \$3,223,400. Petitioner filed its petitions contesting valuation on April 11, 2006, and April 16, 2007. For the reasons below, we find the value of the Subject Property to be \$3,300,000 as of January 2, 2005, and \$ 3,300,000 as of January 2, 2006.

### **Background**

The Subject Property, improved with a six-story high-rise senior apartment building, is located at 200 Levee Drive in Shakopee, Minnesota. It was constructed in 1981 with HUD financing and remains a Section 8 subsidized project. The Subject Property is a good quality, senior, independent living, housing facility, which is well maintained. It has 66 one-bedroom apartments and

also contains the senior citizens' community center (with fully equipped commercial kitchen) for the City of Shakopee. The average rent tenants pay for their apartments is \$225 per month. Each unit is 601 square feet and has a range/oven, refrigerator, air-conditioning sleeve, pull cords in the bedroom and bathroom, and window mini-blinds. One unit has updated appliances, kitchen cabinets, closet shelving, and carpeting. All units are clean and well maintained. Half of the units have patios and decks. Special features include an outdoor terrace, administrative office, commercial kitchen, common laundry room, library with kitchenette area, tub room, exercise room, and a parking lot with 21 parking spaces.

The Subject Property has 55,320 square feet of gross building area and is located on 0.77 acres of land. The construction of the Subject Property is concrete with a brick faced exterior. The foundation is concrete block, and the frame is concrete. The building is heated with hot water baseboard heat. There are sleeves for window air-conditioners in each unit, although residents must purchase their own air-conditioner. Each unit has its own electrical meter.

### **Neighborhood**

The Subject Property has frontage along Levee Drive to the north, with the Minnesota River located on the north side of Levee Drive. On the west are Atwood Street and an area which is primarily single-family residential and retail/commercial. Fuller Street is to the east, which is a retail/commercial area. The subject neighborhood has average local and regional access to and from

adjacent roads, U.S. Highway 169, and State Highway 101. Public transportation, consisting of Metropolitan Transit Commission buses, is available in the area.

### **Burden of Proof**

The assessor's estimated market value is *prima facie* valid.<sup>1</sup> Petitioner may overcome this presumption by introducing credible evidence as to the subject property's market value. After considering all the evidence, the Court makes a determination based on the preponderance of the evidence.<sup>2</sup>

### **Highest and Best Use**

Highest and best use is defined as "the reasonable probable and legal use of vacant land or as improved property that is physically possible, legally permissible, appropriately supported, financially feasible, and results in the highest value."<sup>3</sup> While Petitioner's expert concluded that the highest and best use would be as an unrestricted facility leasing out 25 of the 66 units, the County's expert concluded that highest and best use would be for its continued use as subsidized senior housing.

Petitioner's expert, Stephen Hosch ("Mr. Hosch"), based his highest and best use analysis on the presumption that 62% of the subject building must be shut down. Mr. Hosch gave three reasons for concluding that the only financially responsible approach would be to rent just 25 units while leaving the remaining units vacant: the building is legally nonconforming; the building would be best

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<sup>1</sup> Minn. Stat. § 271.06, subd. 6.

<sup>2</sup> The Pep Boys v. County of Anoka, File Nos. C2-01-2780 et al. (Minn. Tax Ct. Oct. 26, 2004); Swanson v. County of Wright, File No. C0-90-918 (Minn. Tax Ct. June 27, 1991); Gregorich v. County of Anoka, File No. C6-02-4557 (Minn. Tax Ct. Oct. 8, 2003).

<sup>3</sup> The Appraisal of Real Estate, 305 (12<sup>th</sup> ed. 2001).

suited to general population occupancy; and, most significantly, there is an incurable parking deficit.

He opined that the current structure is not legally permissible. We disagree. Mr. Hosch disregarded the fact that the structure was built pursuant to a conditional use permit, the structure is considered a permitted use, and the structure is legally conforming. Furthermore, Mr. Hosch's conclusion that 62% of the building must remain vacant in order to obtain renters for 25 of the units presumed not only that there is a parking problem, but that the problem is incurable. His presumption is not supported by Petitioner's own evidence. Petitioner's property manager and general partner both stated, during the inspection of the Subject Property, that more parking would not make a difference because most of the residents do not drive, given that the average age of the residents is 84 years old.<sup>4</sup> In addition, the City of Shakopee specifically considered the availability of parking in granting the Subject Property's conditional use permit, recognizing the reduced need for parking for senior units. Petitioner's witness, Mary Bujold, testified that limited parking for senior housing is acceptable and not considered substandard.<sup>5</sup> Finally, Mr. Hosch failed to recognize that any parking problem may be mitigated because there is additional space on the property itself which could accommodate more parking without violating zoning provisions.<sup>6</sup>

Mr. Chacka looked at the same factors as did Mr. Hosch in determining highest and best use, but he concluded that the highest and best use is to

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<sup>4</sup> Tr. at 201; Ex. A; Ex. D.

<sup>5</sup> Tr. at 96-7.

<sup>6</sup> Ex. 24, p. 31; Ex. A, p. 43.

continue the property as an independent senior housing property. In doing so, he determined that the quality of the property and its amenities are in line with market expectations of a senior independent living facility. We agree with Mr. Chacka's analysis. Therefore, we find that the highest and best use of the Subject Property (as it is currently being used) is as a subsidized senior housing property.

### **Valuation**

The case law demonstrates that the value of subsidized housing is computed using the same appraisal policies and fiscal data that is used to value a normal unrestricted apartment building.<sup>7</sup> The value of subsidized housing must be "based on the normal approach to value using normal unrestricted rents."<sup>8</sup> Instead of using actual income and expense, "an appraiser must search the market to find comparable, non-subsidized rental property and from that property make an assumption of what the income and expenses would be for the subject."<sup>9</sup>

The Court considers the three traditional approaches (cost, income and sales) to determine market value as outlined in Equitable Life Assurance Soc'y v. Ramsey County.<sup>10</sup> Due to the age of the property, neither witness used the cost approach; however, both witnesses used a sales approach and an income

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<sup>7</sup> Givens & Givens v. County of Hennepin, File No. TC-9408 (Minn. Tax Ct. Dec. 1, 1993); Rockwood Place Apts. Ltd. P'ship v. County of Ramsey, File Nos. C7-03-4285, C0-04-4879 (June 9, 2005).

<sup>8</sup> Minn. Stat. § 273.13, subd. 25(c)(3).

<sup>9</sup> Bergstad Prop. v. County of Goodhue, File Nos. C6-92-340, C8-92-341 (Minn. Tax Ct. July 12, 1993).

<sup>10</sup> 530 N.W.2d 544, 552 (Minn. 1995).

approach. In addition, both experts gave primary consideration to the income approach. We next address each of these approaches.

### **Cost Approach**

Neither witness performed a cost approach because of the age of the building. We agree and do not rely upon the cost approach in our determination of value.

### **Income Approach**

The income approach attempts to find the market value of the subject property by capitalizing the anticipated market level of rent less the market level of expenses. This provides the basis for capitalizing to market value.<sup>11</sup> Both experts considered and used the income approach. Mr. Hosch's final value for the Subject Property under the income capitalization approach to value is \$1,045,000 for January 2, 2005, and \$1,140,000 for January 2, 2006. Mr. Chacka arrived at a final value of \$3,300,000 for both years. In calculating value under the income approach, the appraisers differed significantly in their calculation of fair market rent that the Subject Property could generate. We first turn to how the experts determined market rents.

Market Rent. Under the income approach to value, the starting point for the analysis is the potential gross rents that the Subject Property could generate if it were a market rate facility. Here, because the Subject Property is subsidized housing, the rents are not at market. The experts, therefore, obtained market rental rates from other sources.

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<sup>11</sup> Space Ctr. Enter, Inc. v. County of Ramsey, File No. C4-98-3241 (Minn. Tax Ct. Nov. 4, 1999).

Petitioner's expert, Mr. Hosch, relied upon a study conducted by Maxfield Research, Inc. ("Maxfield") to determine the appropriate monthly market rents for the Subject Property. Maxfield calculated the monthly market rents under two alternative scenarios. First, Maxfield calculated the market rate rent that the Subject Property could generate as-is without any significant improvements, finding it to be approximately \$567 per unit. Second, Maxfield calculated the market rate of rent that the Subject Property could generate if significant improvements were made to the property, arriving at a market rate rent of approximately \$652 per unit. Mr. Hosch agreed with Maxfield's analysis of market rents assuming that the updates were made, determining the market rate rent to be \$650 per unit.

The County's expert, Mr. Chacka analyzed 6 market rate rental properties to determine the Subject Property's potential gross rental income. Mr. Chacka compared five senior independent living buildings chosen because of their similarity to the Subject Property, but concluded that three of those properties, which are Scott County Community Development Association ("CDA") projects, did not fully reflect market value rents compared to the non-CDA projects. The general population building was chosen because of its similarity in size, amenities, age, and condition to the Subject Property. In the end, Mr. Chacka gave the greatest weight to the general population building due to its similarity to the Subject Property and to the senior project closest in age and condition to the Subject Property. Under his income analysis, Mr. Chacka determined an average

market rate of \$685 per unit per month for the Subject Property. We agree with Mr. Chacka for the following reasons.

Mr. Hosch relied upon the Maxfield study in coming up with an average unit rent of \$650 per month, assuming the units and common areas were substantially upgraded. However, the Maxfield report conclusions are for an effective date of April 2007, while the valuations at issue here are as of January 2, 2005, and January 2, 2006.<sup>12</sup> Additionally, the interiors of all but one of the comparables were not viewed so that Maxfield's substantial adjustments for the condition of the comparables were based solely upon the exteriors of the buildings.<sup>13</sup> Moreover, Maxfield adjusted the comparables by 10% because they all had rent subsidies since they had been developed by the HRA. However, Mr. Chacka's appraisal contains a comparable that was not rent restricted, which showed the market difference between HRA properties and general rate properties to be from 17% to 30%. Furthermore, Maxfield adjusted the Lynn Court property as if it were formerly an HRA project despite the fact that it was not. Finally, the Maxfield study made significant adjustments to the comparables based upon the availability of surface parking. However, the study failed to indicate the number of parking spaces at any of the properties and also failed to

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<sup>12</sup> At trial, Maxfield Research President Mary Bujold was questioned by Petitioner's counsel:

Q: And we should I guess clarify what is the effective date of your conclusions concerning these rental rates?

A: The effective date, as stated, is April 2007.

Q: Do you believe that those amounts would be significantly different from the amounts that would be generated if the effective date were January 2, 2005?

A: Well, yes, it would be.... Tr. at 82.

<sup>13</sup> It is noteworthy that the only property that was actually viewed on the inside garnered the lowest adjustment of all the comparables.

note that one of the comparables (Hamilton) had no surface parking at all. We question Maxfield's adjustments, which were the same for all the comparables despite the fact that surface parking for the comparable properties varied from no surface parking to 50% parking. The Maxfield study also did not factor in the \$40 additional cost that renters at the comparable properties were required to pay for the benefit of parking.

Mr. Hosch relied heavily upon the Maxfield study, which we find to be problematic. Although Mr. Hosch did conduct his own rent comparable analysis, he did not include any explanation of his analysis or an adjustment grid. We find Mr. Chacka's analysis to be more persuasive that the appropriate market rental rate during the times at issue is \$685 per unit.

Other Income. Mr. Hosch estimated other income at \$42,300 per year, which includes income from the City of Shakopee for its community center (\$21,300) and roof-top rental for cellular phone use (\$21,000). Mr. Chacka estimated additional income for laundry fees, forfeited security deposits, application fees, move out charges, late fees, and other miscellaneous fees at \$16,500. We adopt Mr. Chacka's conservative figure, recognizing that his final calculation would have been adjusted upward had he taken into account rental income from the community room and rooftop cell tower.

Net Operating Income. The experts used significantly different net operating incomes in valuing the Subject Property: Mr. Hosch found the net operating income before deducting real estate taxes to be \$87,125, while Mr. Chacka determined it to be \$270,262. The difference is due to Mr. Chacka's use

of a higher gross income and less operating expense than Mr. Hosch. For his analysis, Mr. Hosch relied upon the actual expenses provided to him from Petitioner<sup>14</sup> although he factored out some upgrades and decorating undertaken on the property and made further reductions attributable to closing half the building. Mr. Hosch also takes into account an amount claimed to be the cost to upgrade the units. Mr. Chacka calculated expenses using six comparable multi-family projects, three of which were market rent projects and three of which were restricted rent projects. Where the Subject Property had historical data that called into question widely divergent expenses among the comparables, Mr. Chacka considered the historical data. In addition to an amount for repair and maintenance expenses, his calculations allowed a \$250 replacement reserve contribution.

We agree with Mr. Chacka's final expense calculation, which was 48.13% of the estimated gross income for the Subject Property, for several reasons. First, case law is clear that we must use market, not actual, expenses in valuing a subsidized housing project.<sup>15</sup> Although Petitioner attempts to justify Mr. Hosch's reliance on actual expenses by arguing they are within the range of expenses typically seen in the area, the study relied upon shows an average expense calculation of 44.6%, which is much closer to Mr. Chacka's final expense calculation than Mr. Hosch's. Further, Mr. Hosch's methodology takes into account the cost Petitioner claims is required to upgrade the units, but there was

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<sup>14</sup> Tr. at 125-27.

<sup>15</sup> Bergstad Properties v. Goodhue, supra. See also Givens v. Givens, supra, and Hutchinson Partners v. County of McLeod, File Nos. C1-92-24446, C3-92-24447 (Minn. Tax Ct. Dec. 1, 1993).

no evidence that such improvements are necessary to make the Subject Property rentable. There is nothing in the record showing that comparable units in the area differ or are in such superior condition as to require that the Subject Property be extensively improved in order to rent it. Mr. Hosch did not discuss the unit conditions of any of the comparables he used but rather, relied upon the property amenities to justify his rent valuations. Additionally, the Maxfield study upon which Mr. Hosch relied, viewed only one of the comparables and made a very modest \$30 adjustment for condition. The only evidence of the Subject Property's condition is in the appraisal of Mr. Chacka who ranked it next to the comparables which he actually toured. Finally, Mr. Chacka made an appropriate deduction for improvements by use of replacement reserves, which is the more appropriate manner in which to handle such concerns.<sup>16</sup>

Capitalization Rate. The next step in obtaining a value under the income approach is to determine and apply a Cap Rate. The Cap Rate is a yardstick or indicator of the risk associated with the purchase of an income producing property. Generally, the Cap Rate is a measure of the return on investment that an investor will demand in exchange for risk; the lower the risk, the lower the Cap Rate. Mr. Hosch employed a Cap Rate of 6% for 2005, combined with a real estate tax rate of 1.33%, for an overall capitalization rate plus tax factor of 7.33%. Mr. Hosch employed a Cap Rate of 5.25% for 2006, combined with a real estate

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<sup>16</sup> Mr. Hosch adjusted for updates by deducting the assumed costs of those updates from his appraised value for the Subject Property using the income approach. As we stated in 200 Levee Dr. Ass'n, Ltd. v. County of Scott, File No 93-05889 (Minn. Tax Ct. Apr. 18, 1994), "[m]ost conversion costs can be handled better by allowing an appropriate reserve for replacements in estimated expenses and by properly estimating the amount of 'market' rent that can be generated by this type of property once it is no longer subsidized." Similarly, in Hutchinson Partners v. County of McLeod, supra, we indicated it is preferable to reduce the gross income rather than make a subtraction at the end of the valuation process as Mr. Hosch did.

tax factor of 1.34%, for an overall capitalization rate of 6.59%. Mr. Chacka employed a Cap Rate of 6.75% and an effective tax rate of 1.34%, resulting in an adjusted capitalization rate of 8.09% for each year. As a check, Mr. Chacka used a Band of Investment analysis and found that his initial calculation was appropriate.

Based upon the experts' testimony and other data found in their appraisals, a 6.75% Cap Rate is appropriate for 2005 and 2006. We agree with both experts that the effective tax rate of 1.3% is appropriate. After dividing the net operating income by the overall Cap Rate, we find that the value under the income approach for January 2, 2005, is \$3,300,000 and for January 2, 2006, is \$3,300,000.

### **Sales Approach**

Under the sales comparison approach, the appraiser evaluates sales of similar properties and adjusts for such factors as size, age, location, time of sale, terms of sale, land to building ratio, and quality of construction.<sup>17</sup>

Both expert witnesses prepared a sales approach analysis. Mr. Hosch testified that the fair market value of the Subject Property under the sales approach was \$1,165,000 as of January 2, 2005, and \$1,255,000 as of January 2, 2006. In his appraisal, he determined a per unit value of \$53,500 for 2005 and \$57,500 for 2006 and then applied those figures to his partial building (25 out of

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<sup>17</sup> The Appraisal of Real Estate, 425-27 (12<sup>th</sup> ed. 2001); see Hallberg Marine, Inc. v. County of Chisago, File No. CV-05-343 (Minn. Tax Ct. Jan. 16, 2007); Meldahl v. County of Hennepin, File No. 31899 (Minn. Tax Ct. Jan. 17, 2006); Houser v. Hennepin County, File No. 29232 (Minn. Tax Ct. Dec. 30, 2004).

66 units he opined could be sold) to arrive at his final values (after deducting \$7,000 per unit to upgrade units to general market rate condition).

Mr. Chacka valued the Subject Property under the sales approach at \$3,400,000, using five multifamily properties sold between April 2004 and November 2005 as comparables. He found a range of per unit values from \$48,611 to \$74,779 before any adjustments, with an average of \$59,213 per unit. Rather than adjusting the comparable sales for characteristic differences with the Subject Property, Mr. Chacka adjusted each of the comparables based on their income producing potential. He considered all comparable sales chosen to be similar in investment class to the Subject Property except Comparable 5, which was superior. After omitting Comparable 5 from the analysis, the other comparables range from \$48,611 to \$58,962, with an average of \$52,821 per unit. Mr. Chacka mainly relied upon the sales analysis to confirm his income approach value of \$50,000 per unit or \$3,300,000 for the Subject Property.

We note that the experts arrived at roughly the same amount per unit and that if Mr. Hosch had applied his per unit values to all of the units, his final values would have been \$3,531,000 and \$3,795,000 under the sales comparison approach. Thus, we must again address the propriety of Mr. Hosch's using only 38% of the units in the building in his valuation of the Subject Property. For the reasons previously stated, we cannot agree with Mr. Hosch's conclusion that it is necessary to leave 41 units vacant in order to obtain renters for the remaining 26 units in the Subject Property. We, therefore, find the value of the Subject Property to be \$3,300,000 using the sales comparison approach.

## **Reconciliation and Conclusion**

For the assessment dates January 2, 2005, and January 2, 2006, we find the Subject Property's value to be \$3,300,000. We give more weight to the income approach because the Subject Property is income-producing, but find that the sales comparison approach supports these valuations.

S. A. R.