

WISCONSIN COURT OF APPEALS
DISTRICT 2

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REGENCY WEST APARTMENTS LLC,

Plaintiff-Appellant,

v.

Appeal No. 2014AP002947

CITY OF RACINE,

Defendant-Respondent.

**Appeal from Circuit Court of Racine County
The Honorable Gerald P. Ptacek, Presiding
Circuit Court Nos. 13-CV-1546 and 13-CV-1848**

APPELLANT'S BRIEF AND APPENDIX

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INTRODUCTION

These consolidated *de novo* actions were commenced under Wis. Stat. § 74.37 to recover refunds of excessive property taxes assessed by the City of Racine (“City”) for the years 2012 and 2013. The property at issue is a 72-unit IRC § 42 low income housing tax credit development (the “subject property”). The City assessed the subject property at \$4,425,000 and \$4,169,000 for the years 2012 and 2013, respectively. Plaintiff-appellant Regency West Apartments LLC (“plaintiff”) contends the actual fair market values for those years were \$2,700,000 and \$2,730,000.

Following a bench trial, the trial court entered judgment in favor of the City, upholding the 2012 and 2013 assessments. The trial court’s rationale is fraught with legal errors, demonstrating its disregard for special considerations in valuing § 42 properties. Application of the correct law mandates the reversal of the judgment and direction of judgment in plaintiff’s favor.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Did the trial court err in concluding that HUD § 8¹ rent subsidized properties and a predominantly market rate apartment complex are “reasonably comparable” to the plaintiff’s IRC § 42² low income housing tax credit property and that it was appropriate for the City’s

¹ 42 U.S.C. § 1437f.

² 26 U.S.C. § 42.

assessors to rely upon such properties in applying the comparable sales approach?

The trial court ignored the governing Wisconsin Property Assessment Manual (“WPAM”) and undisputed evidence regarding material differences between HUD § 8 and IRC § 42, and between market rate and § 42 properties, and accepted the assessors’ sales as reasonably comparable to the subject property.

2. Did the trial court err in excusing the assessors’ violation of law in utilizing estimated rather than actual expenses in applying their income valuation methodology?

The trial court acknowledged that the assessors erred in using a market expense ratio rather than plaintiff’s actual expenses for purposes of their income approach. The court concluded the error was immaterial because the 2013 assessment was based on the comparable sales approach, even though the 2012 assessment was based solely on the income approach, and even though the comparable sales approach was not a valid methodology for 2013.

3. Did the trial court err in upholding the market derived base capitalization rate the assessors used for their income approach even though that rate was derived from sales of market rate apartment buildings rather than from sales of restricted properties similar to plaintiff’s § 42 property?

The trial court upheld the assessors' capitalization rate based solely upon Mineral Point Valley Ltd. P'ship v. City of Mineral Point Bd. of Review, 2004 WI App 158, 275 Wis. 2d 784, 686 N.W.2d 697. That case involved subsidized interest rates under HUD § 515 for which the capitalization rate was determined using the band of investment method, not the market derived method used by the assessors.

4. Did the trial court err in concluding that plaintiff's expert failed to comply with Wisconsin law by basing his valuations solely on the income approach?

The trial court ignored controlling legal authority and discredited the testimony and opinions of plaintiff's expert, Scott McLaughlin, because he concluded the income approach was the only approach that reliably could be applied in valuing the subject property.

5. Did the trial court err in concluding that plaintiff's expert's application of the income valuation approach failed to comply with Wisconsin law?

Based on its misreading of Mineral Point Valley, the trial court held that McLaughlin's application of the income approach failed to comply with Wisconsin law because he utilized a capitalization rate derived from sales of other IRC § 42 properties rather than a rate derived from sales of market rate apartment buildings. The court also held McLaughlin failed to follow the WPAM steps for valuing properties like plaintiff's, without

specifying in what respects his appraisals allegedly deviated from those steps.

6. Did the trial court err in concluding that plaintiff's evidence failed to overcome the presumption of correctness of the assessments?

Notwithstanding that plaintiff established the 2012 and 2013 assessments violated the WPAM and other controlling legal authorities, and notwithstanding that plaintiff presented competent expert testimony and other significant contrary evidence demonstrating that the 2012 and 2013 assessments are excessive, the trial court held that plaintiff's evidence did not overcome the presumption of correctness of the 2012 and 2013 assessments.

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

Plaintiff requests oral argument and publication of the Court's decision. This appeal raises issues with substantial and continuing public interest regarding the assessment of subsidized housing, and the Court's decision will have significant value as precedent. Wis. Stat. §§ 809.22, 809.23.

STATEMENT OF THE CASE

A. Procedural History

The City assessed the subject property at \$4,425,000 as of January 1, 2012. Plaintiff did not receive a 2012 assessment notice until after the board of review had adjourned, but it filed a timely claim for excessive

assessment.³ The City denied the claim. Plaintiff then filed a *de novo* refund action pursuant to Wis. Stat. § 74.37(3)(d), Case No. 13-CV-1546 (“the 2012 action”). (R.2.⁴)

The City assessed the subject property at \$4,169,000 as of January 1, 2013. Plaintiff filed an objection with the board of review; the board upheld the assessment following a hearing. Plaintiff filed a timely claim for excessive assessment, which the City denied. Plaintiff then filed a § 74.37(3)(d) refund action, Case No. 13-CV-1848 (“the 2013 action”). (Case No. 13-CV-1848, R.2.)

The trial court consolidated the 2012 and 2013 actions for trial. (R.17.) The court heard evidence on four days, commencing May 20, 2014 and concluding July 11, 2014. Plaintiff presented the testimony of its representative, Michael Lerner, who has over 40 years’ experience developing, buying, selling, and managing both IRC § 42 and HUD § 8 properties and who explained at length the differences between these two federal programs. (Lerner, R.37, pp. 128-31, 161-63, 166-208.⁵) Plaintiff

³ The City moved for summary judgment to dismiss the 2012 action, claiming plaintiff failed to exhaust board of review objection procedures. The trial court denied the motion and ruled that plaintiff was not obligated to exhaust board of review procedures based on the unrefuted evidence that plaintiff did not receive a 2012 assessment notice. (R.15.) The City has not cross-appealed to challenge that order.

⁴ Except as otherwise noted, record cites in this brief refer to the record on appeal in Case No. 13-CV-1546.

⁵ Excerpts from the trial transcript are cited with the name of the witness, the record item for the volume of the transcript, and the pages of the transcript. Trial exhibits are referenced as “Ex. ____.”

also presented the testimony of its independent expert, Scott McLaughlin, who has specialized in appraising § 42 and § 8 properties for over 25 years. (Ex. 40; McLaughlin, R.38, pp. 73-76.) The City presented testimony from the assessors and its outside appraisers, Peter Weissenfluh and Dan Furdek, none of whom has any experience with § 42 and § 8 properties. (Anderson, R.37, p. 5; Scites, R.39, p. 11; Weissenfluh, R.40A,⁶ pp. 31-37.)

Plaintiff filed post-trial briefs and proposed Findings of Fact and Conclusions of Law that detail the trial evidence and applicable law and point out numerous deficiencies with the assessors' methodology and the competency and appraisals of the City's outside appraisers. (R.27, R.27A, R.30.) The City filed post-trial briefs but did not submit proposed findings and conclusions. (R.28, R.29.)

The trial court issued its written Decision on November 4, 2014. (R.31; A-App. 1.) The Decision only briefly and generally references the trial testimony. The court ruled that plaintiff failed to overcome the presumption of correctness of the 2012 and 2013 assessments, and that the assessments were not excessive, based on the following legal conclusions:

1. The properties upon which the assessors relied were sufficiently similar to the subject property to allow for a valid comparison under the comparable sales approach. (Id. at 8.)

⁶ This Court granted plaintiff's motion to supplement the record to add the July 11, 2014 trial transcript. (Feb. 3, 2015 Order.) Plaintiff assumes that transcript will be designated as record item 40A.

2. The assessors' erroneous use of a market expense ratio rather than plaintiff's actual expenses for their direct capitalization of income approach was immaterial because the 2013 assessment was based on the comparable sales approach. (Id. at 8-9.)

3. The assessors' reliance for their income approach on a capitalization rate derived from sales of market rate apartments rather than sales of § 42 tax credit properties was proper under Mineral Point Valley. (Decision, R.31, p. 9.) Conversely, plaintiff's expert, McLaughlin, failed to follow Wisconsin law when he (according to the court) applied a "subsidized interest rate" rather than "the market mortgage interest rate" for his income valuation. (Id. at 11.)

4. McLaughlin failed to follow Wisconsin law because he relied solely on the income approach in valuing the subject property. (Id. at 10-11.)

5. McLaughlin's income valuation failed to follow the step-by-step method for assessing federally subsidized housing set forth in the WPAM. (Id. at 10-11.)

Curiously, the Decision directed plaintiff to submit findings of fact, conclusions of law and a judgment. (Id. at 11.) Before plaintiff had an opportunity to do so, the City submitted a proposed order for judgment and judgment that incorporated findings and conclusions set forth in the Decision in lieu of preparing specific factual findings and legal

conclusions. The court entered judgment on November 20, 2014 in the form requested by the City. (R.32; R.33; A-App. 13.) Regency West timely appealed on December 19, 2014. (R.36.)

B. Statement of Facts

1. IRC § 42 versus HUD § 8

The WPAM recognizes the unique challenges involved in valuing various types of low income housing developments subject to different federal assistance programs. The WPAM describes 10 such federal programs involving mortgage insurance, mortgage interest reduction, income tax credits, or rent subsidies. (WPAM, Ex. 34, pp. 9-38 to 9-42.) The WPAM uses the short-hand term “federally subsidized housing” to describe all of these programs, although income tax credits under IRC § 42 do not involve a subsidy of any type. For purposes of this case, the parties also have used the term “subsidized housing” to describe both § 42 tax credits and true subsidy programs such as HUD § 8.

a. IRC ¶ 42 Tax Credit Program

IRC § 42 is a U.S. Treasury program that incentivizes developers to develop affordable housing by providing federal tax credits that can be sold to raise equity to pay down construction debt, thereby enabling the project to rent units about \$150-\$250/month below a comparable unit without tax credits. In Wisconsin, the § 42 tax credit program is administered by the

Wisconsin Housing and Economic Development Association (“WHEDA”). (WPAM, Ex. 34, p. 9-40; Lerner, R.37, pp. 163, 166-67.)

There are significant investment risks with § 42 properties. Section 42 credits are claimed as dollar-for-dollar credits against investors’ income taxes over a period of 10 years and are not renewable. In exchange for receiving the tax credits, the developer gives up the right to sell the project for a use other than affordable housing for the period of the Land Use Restriction Agreement (“LURA”) – a contract with WHEDA – which extends beyond the duration of the tax credits, usually 30 years. During the term of the LURA, the developer is obligated to continue to rent to low income tenants according to the set-asides in the LURA. If a project falls out of compliance after the tax credits expire, the investors who purchased the tax credits are obligated to repay the credits, with significant penalties and interest. (WPAM, Ex. 34, p. 9-40; Lerner, R.37, pp. 168, 170-71, 173, 183-84.)

WHEDA determines the maximum rents that may be charged to § 42 tenants at different county median income (“CMI”) levels. (Ex. 24.) There are no rent subsidies and no protections against vacancy losses. The owner therefore bears all the risk of tenants not paying their rents and bears all the risk of vacancy losses. Section 42 tenants not only have to meet the LURA income restrictions, but also must earn sufficient income to pay the rent,

which narrows the market of eligible tenants to 11.8% – 14.3% of the total rental market. (Ex. 27; Lerner, R.37, pp. 174-76, 191, 196.)

Section 42 tax credit properties are subject to ongoing rules and regulations that impose significant operational compliance costs. Every tenant must be qualified through verification procedures similar to those involved in obtaining a bank loan, requiring additional management time. Reports must be filed with WHEDA, § 42 developers are obligated to obtain and file annual financial audits, and WHEDA conducts regular on-site inspections at the developer's expense. (Lerner, R.37, pp. 161, 187.) Section § 42 developers are not entitled to any automatic rent increases and cannot just raise rents to meet growing expenses due to the rent restrictions imposed by WHEDA based on the set-asides in the LURA. (Id. at 188.)

The specific characteristics of § 42 properties vary widely. In addition to the typical variations in physical features, size and location of apartment complexes, § 42 properties vary in unit mixes (i.e. number of bedrooms per unit) and set-asides. One § 42 development may have all 1-bedroom and 2-bedroom apartments with 60% set-asides (i.e. eligible tenants may earn up to 60% of CMI), while another could have 2-bedroom and 3-bedroom apartments with a combination of 50% and 60% set-asides. WHEDA rent restrictions are based on both the number of bedrooms and percentage of CMI, so those variances have a direct impact on revenues. (Ex. 24; Lerner, R.37, pp. 174-77, 179.) Moreover, CMI levels vary by

county, as do utility allowances, which are deducted from the maximum rents the developer may charge. So identical § 42 project configurations may generate very different rent revenues depending on the counties in which they are located. (Lerner, R.40A, pp. 177, 179-82.)

Some § 42 properties serve senior citizens, some serve families, and some serve both. The type of tenant affects operational expenses, because there are higher turnover rates and higher maintenance expenses with family units. (Lerner, R.37, p. 161.)

As a result of both the operational and investment risks described above, there is a very limited market for § 42 properties. (Ex. 36, p. 356; Lerner, R.37, pp. 170-71, 185-86; McLaughlin, R.38, pp. 82, 105; R.40A, pp. 212, 264-65.) To the extent these properties do change hands, buyers rely exclusively upon the income approach in making investment decisions and do not give consideration to the comparable sales approach. (Lerner, R.37, pp. 128-29, 208-11.)

b. HUD § 8 Rent Subsidy Program

HUD § 8 is a completely different program with completely different benefits and restrictions than IRC § 42.

HUD § 8 is a true subsidy program. Rents are established through a housing assistance payments (“HAP”) contract with HUD or WHEDA. Tenants may earn anywhere from 0 to 80% of CMI, which means 50% of the total tenant market is eligible for § 8 housing – about four times the

market of eligible § 42 tenants. (Ex. 27; Lerner, R.37, pp. 201-08.) Section 8 tenants pay 30% of their income for rent. Whatever amount the tenants cannot afford to pay is paid by the government. The government subsidy portion of the rent is automatically deposited in the owner's bank account, eliminating collection risks. (Lerner, R.37, pp. 192-93.)

Owners of § 8 projects get the benefit of automatic rent increases which often result in payment of above-market rents. Section 8 projects also benefit from vacancy protection. If a § 8 unit goes vacant and is still vacant after 15 days, the government pays up to 80% of the HAP contract rent for 60 days, then 100% of the debt service attributable to that unit for up to a year. Moreover, § 8 HAP contracts are renewable. (Id. at 194-95.)

Due to the guaranteed rents, renewability, and low risk associated with § 8 properties, such properties are highly desirable, and there is a constant market for them. (Id. at 192-196, 200-01; McLaughlin, R.38, pp. 79-81, 143.)

2. Description of the Subject Property

The subject property is a 100% § 42 property consisting of nine 8-family apartment buildings, each with four 3-bedroom and four 2-bedroom units. There is also a community center with a manager's office and community room, and 3 stand-alone garage structures with 12 garages in each. The property has no elevators and no underground parking. The

project is situated on 7 acres of land located just west of the vacant Sam's Club and south of the City dump. (Id. at 164-65, 253-56.)

All 72 apartment units in the subject property are income and rent restricted. Under plaintiff's 30-year LURA, 51 of the 72 units must be rented to tenants who earn 50% or less of CMI, and 21 of the units must be rented to tenants who earn 60% or less of CMI, except that two units are provided rent-free to plaintiff's employees. (Id. at 127, 170; Lerner, R.38, pp. 3-4.) Four of the 36 garage units also are unavailable for rent. (Lerner, R.38, p. 4.) The subject property was constructed in 2010-11 and was fully leased as of February 1, 2012. (Lerner, R.37, p. 165.)

3. The 2012 Assessment

The subject property was assessed in 2012 and 2013 by Janet Scites, and the assessments were reviewed and approved by the City's assessor, Ray Anderson. Neither Scites nor Anderson has any experience buying, selling, or managing subsidized housing projects. (Anderson, R.37, p. 5; Scites, R.39, p. 11.)

For the 2012 assessment, the assessors relied exclusively upon the direct capitalization of income approach in arriving at their value of \$4,425,000. (Ex. 11; Anderson, R.37, p. 16.) That method converts a single year's net operating income ("NOI") into an estimate of value by dividing the property's NOI (income less expenses) by the applicable capitalization rate. (WPAM, Ex. 33, pp. 9-13, 9-21.) The capitalization

rate, or “cap rate,” is the ratio between the NOI of other properties and their sale prices and provides an estimate of investors’ expected rate of return on their investments. (*Id.*, Anderson, R.37, p. 33.)

As of January 1, 2012, the valuation date for the 2012 assessment, plaintiff had only been operating for a couple of months and did not yet have audited financial statements available. However, as of that time plaintiff’s actual rents were known, and its expenses had been projected consistently, and independently, by four different sources, including WHEDA, which approved plaintiff’s project for federal tax credits after an extensive financial analysis. (Ex. 42; Lerner, R.37, pp. 212-31, 241-42; R.38, pp. 10, 49.)

For purposes of the 2012 assessment, the assessors assumed potential gross income of \$639,360 and a 5% vacancy rate, which were similar to the assumptions in a prospective appraisal commissioned from Cambridge Partners in 2010 by plaintiff’s construction lender, a copy of which plaintiff provided to the assessors in 2011. (Ex. 11; Ex. 13; Anderson, R.37, pp. 23, 28-30; Lerner, *id.* at 235.) However, the assessors rejected the expense projections in the Cambridge Partners appraisal as supposedly too high in comparison to other § 42 properties in the area (Anderson, R.37, pp. 28-30; Scites, R.39, pp. 5, 44) – even though those projections were well within WHEDA’s parameters. (Ex. 25; Lerner, R.37, pp. 215-21.) Instead of applying the specific expenses applicable to the

subject property, the assessors applied a 40% estimated expense ratio supposedly based on expense ratios for other § 42 properties.⁷ (R.11; Anderson, R.37, pp. 25, 27-28, 30; Scites, R.39, p. 5.) As a result, the assessors assumed expenses of only \$250,000 per year excluding property taxes, as compared with plaintiff's actual expense projection of \$328,500 excluding taxes. (R.11; Anderson, R.37, pp. 29-30.) The assessors thereby computed an NOI of \$376,099, which was 37% higher than Cambridge Partners' projected NOI of \$274,000. (Ex. 11; Anderson, R.37, pp. 32-33.)

The assessors purported to apply a market derived cap rate, the method preferred by WPAM. (WPAM, Ex. 33, p. 9-24; Anderson, R.37, pp. 33-34.) They derived their 6.0% base cap rate from sales of market rate apartments, however, not from sales of § 42 properties. Adding the City's property tax rate for 2012, this computed to a loaded cap rate of 8.5%. (Anderson, R.37, pp. 37-39; Scites, R.38, p. 237.) Dividing their NOI by their loaded cap rate, the assessors arrived at a value of the subject property of \$4,425,000 for 2012 (Ex. 11), as compared with the Cambridge appraisal projected as-stabilized value of \$2,600,000. (Ex. 13, p. 60.)

⁷ The assessors refused to produce any evidence supporting their reliance on a 40% expense ratio in response to plaintiff's public records and discovery requests, claiming confidentiality, and they never in fact substantiated that ratio. (Anderson, R.37, pp. 31-32.)

4. The 2013 Assessment

For the 2013 assessment, the assessors relied upon the comparable sales approach. (R.12; Anderson, R.37, p. 56; Scites, R.39, p. 9.) They also performed an income valuation as a cross-check, using the same assumptions as their 2012 income valuation. (Anderson, R.37, pp. 52-54.)

The assessors relied upon three so-called “comparable sales” for purposes of the 2013 assessment: (1) Woodside Village/Albert House, (2) Lake Oakes, and (3) McMynn Tower. (Ex. 12; Anderson, R.37, p. 69.) There are significant physical and economic differences between the subject property and the assessors’ comparable sales, including the following:

Woodside Village/Albert House consists of two different projects in two different locations. While the 50 units in the Woodside Village project are family units like plaintiff’s, the 104 units in the Albert House project are all senior living, with an elevator. The majority of the units in comparable sale (1) are 1-bedroom, whereas the subject property has all 2-bedroom and 3-bedroom units. All the units in comparable sale (1) are HUD § 8 units, whereas all of the units in the subject property are IRC § 42 units. (Ex. 12, p. 9; Lerner, R.37, pp. 254-56.)

Lake Oakes consists of two developments built at different times. All of the units in one of the developments, and about a third of the units in the other, are senior living. Lake Oakes has all 1-bedroom and 2-bedroom

units, with no 3-bedroom units. The vast majority of the units are market rate apartments not subject to any restrictions; there are only a few § 42 units.⁸ Lake Oakes overlooks Lake Michigan, compared with the subject property's location next to the City dump and empty Sam's Club. Lake Oaks has elevators and underground parking; the subject property has neither. (Ex. 12, p. 10; Lerner, R.37, p. 753; McLaughlin, R.38, p. 145; Ex. 61.)

McMynn Tower is a high rise apartment building devoted exclusively to senior living, with no family units. All of the units are 1-bedroom, and all are § 8, with no § 42 units. This building is located in downtown Racine, overlooking Lake Michigan. McMynn Tower also has a significant commercial component, with 8-10% of its total income derived from cell towers and office space, whereas the subject property has no commercial component.⁹ (R.12, p. 11; Lerner, R.37, p. 256; Scites, R.39, pp. 33, 36; McLaughlin, R.38, p. 147.)

In applying the comparable sales approach for their 2013 assessment, the assessors did not even attempt to obtain, much less actually obtain, the agreements setting forth the specific restrictions applicable to their three comparison properties. Rather, they simply assumed that § 42

⁸ The assessors' 2013 report does not disclose that the majority of the Lake Oakes units are market rate apartments. (Ex. 12, p. 10; Anderson, R.37, p. 80; Lerner, *id.* at 253.)

⁹ The assessors' report also fails to disclose McMynn Tower's commercial use. (R.12, p. 11; Scites, R. 39, p. 36.)

and § 8 restrictions are similar and concluded their comparison properties were reasonably comparable based on allegedly similar rents. (Anderson, R.37, p. 101; Scites, R.39, pp. 13, 56.)

The assessors placed primary reliance on the Woodside Village/Albert House § 8 sale and arrived at a value of \$4,169,000 under their comparable sales approach. They admitted the validity of their 2013 assessment depends on the propriety of treating § 8 and § 42 properties as reasonably similar. (Ex. 12, p. 3; Anderson, R.37, p. 88; Scites, R.39, pp. 37-38.)

In applying the income approach for their 2013 assessment, the assessors continued to rely upon their 40% expense ratio even though they possessed plaintiff's year-end 2012 audited financial statements establishing much higher actual expenses, and even though they had no basis to dispute those financial statements. (Anderson, R.37, pp. 45-46, 52-54; Scites, R.39, p. 5.) They also used the same 6% base cap rate as for their 2012 assessment. The property tax rate for 2013 was higher than the 2012 rate, resulting in a higher loaded cap rate of 9.0% for 2013. The assessors' income approach therefore suggested a value of \$4,129,000. Based on their comparable sales approach, the assessors assessed the subject property at \$4,169,000 for the year 2013. (R.12, p. 4; Anderson, R.37, p. 57; Scites, R.38, p. 252.)

5. Plaintiff's Expert Appraisals

Plaintiff's expert, Scott McLaughlin, is an experienced appraiser who specializes in valuing subsidized housing. He has appraised literally hundreds of subsidized housing projects on behalf of lenders and investors over the past 25 years and has even been retained to appraise properties for WHEDA, the very agency responsible for administering § 42 tax credit properties in Wisconsin. McLaughlin is intimately familiar with the different restrictions that apply to such projects and variances in the markets for different types of subsidized housing. (Ex. 39; McLaughlin, R.38, pp. 73-88, 104-06, 143-47.)

McLaughlin opined that the 2012 and 2013 assessments fail to comply with the WPAM and generally accepted appraisal practices. Among other criticisms, he concluded that the assessors' income valuations for 2012 and 2013 were inflated because they relied upon a market expense ratio rather than plaintiff's actual expenses, and because they understated the cap rate. (Ex. 40, ¶¶ 7, 9; McLaughlin, R.38, pp. 140-41, 160.) He further concluded that the comparable sales method was not a reliable method for valuing the subject property due to the absence of sales of properties with similar restrictions, set-asides, physical characteristics, tenants and amenities; that the assessors' 2013 comparable sales valuation erroneously used § 8 properties as comparable sales based on allegedly similar rents, disregarding the lack of similar restrictions; and that the

assessors failed to make appropriate adjustments for differences in rent and income restrictions. (Ex. 40, ¶¶ 4, 10; McLaughlin, R.38, pp. 101-07, 141-47, 151-59, 193, 215.) McLaughlin prepared a report card summarizing the assessors' violations of the WPAM and other deficiencies with the 2012 and 2013 assessments. (Ex. 47.)

In addition to critiquing the assessments, McLaughlin also independently appraised the subject property as of January 1, 2012 and January 1, 2013. McLaughlin did not apply the comparable sales approach because he was unable to obtain data on other properties' specific restrictions, without which a reliable comparable sales analysis cannot be performed. Instead, he relied upon the direct capitalization of income approach, which is the industry standard for subsidized housing. (McLaughlin, R.38, pp. 76, 101-06, 108; Ex. 40, ¶¶ 4-5.)

In applying the income approach, McLaughlin relied upon the best information that would be available to and relied upon by a prospective buyer as of the applicable valuation date, which is the appropriate consideration for a retrospective appraisal. (McLaughlin, R.38, p. 100.) He also considered the specific rent and income restrictions applicable to the subject property as set forth in its LURA. (Id. at 111.)

For his January 1, 2012 valuation, McLaughlin relied on plaintiff's 2012 projections prepared in November of 2011, which were consistent with projections independently prepared by three other sources, including

WHEDA. (Ex. 42; McLaughlin, R.40A, pp. 244-45; Lerner, R.37, p. 242; R.40A, p. 172.) For his January 1, 2013 valuation, McLaughlin relied upon plaintiff's audited financial statements prepared by a highly acclaimed public accounting firm for the year ending December 31, 2012, which he found to be entirely reliable. (Ex. 40; Ex. 43; Ex. 44; McLaughlin, R.40A, p. 245; Lerner, R.37, p. 249.) He thus complied with the WPAM's directive of using the subject property's specific income and expenses, not market rates, in valuing a subsidized housing project. (WPAM, Ex. 34, p. 9-43.)

Based on the subject property's income and expenses, for 2012 McLaughlin calculated potential gross income less vacancy losses at \$593,740, and operating expenses totaling \$308,840, for an NOI of \$284,900. (Ex. 40, p. 3.) For 2013, he calculated potential gross income less vacancy losses at \$618,164, and operating expenses totaling \$332,860, for an NOI of \$285,304. (Id., p. 4.)

McLaughlin also complied with the WPAM by applying market derived cap rates determined from sales of similar properties, i.e. other § 42 properties. (WPAM, Ex. 33, p. 9-24; McLaughlin, R.40A, pp. 213-14.) He personally collected cap rate data for other § 42 sales (Ex. 46), which are unrefuted. Based on that market derived data, he applied a base cap rate of 8.0% for 2012 and 7.6% for 2013. (McLaughlin, R.40A, pp. 214-15.) He added the City's tax rates for 2012 and 2013 to the base cap rates, as the

WPAM requires, resulting in loaded cap rates of 10.54% and 10.447%, respectively. (Ex. 40, pp. 3-4; WPAM, Ex. 33, p. 23; Andersen, R.37, p. 107.)

Having computed the subject property's NOIs in compliance with the WPAM, and having determined the applicable cap rates in compliance with the WPAM, McLaughlin then divided the NOIs by the cap rates to arrive at his values of \$2,700,000 for 2012 and \$2,730,000 for 2013. (Ex. 40, pp. 3-4; McLaughlin, R.38, p. 139; WPAM, Ex. 33, pp. 9-13, 9-21.)

6. The City's Outside Appraisers

The City's outside appraisers, Dan Furdek and Peter Weissenfluh, are experienced general assessors but have no expertise whatsoever with respect to any type of subsidized housing. Neither has ever bought, sold or managed a subsidized housing project, and neither had ever assessed or appraised a subsidized housing project in their lives until the City retained them in this case. (Furdek, R.40A, pp. 31-36; Weissenfluh, R.40A, pp. 147-48.) Both spent most of their careers in the Milwaukee assessor's office, where other assessors were responsible for assessing subsidized housing. Notably, the Milwaukee assessor's office uses the income approach in assessing subsidized properties, not the comparable sales approach. (Furdek, R.40A, p. 37; Weissenfluh, *id.* at 148-49.)

While Furdek and Weissenfluh reviewed publications and presentations on valuing subsidized housing, including the WPAM, for

purposes of their work in this case, they ignored the instructions in those resources. For example, the resources they reviewed caution that § 42 is the “most complicated” subsidized housing program and presents “complex” valuation challenges requiring “special competency.” (Ex. 53, p. 2; Ex. 54, pp. 1-2, 10; Furdek, R.40A, p. 48.) Yet Furdek testified there is nothing complicated about appraising a § 42 property, and he did not do anything differently in appraising the subject property than he would do in appraising any other commercial property. (Furdek, R.40A, pp. 37-38, 42.) Furdek and Weissenfluh also disregarded the unanimous recognition that the comparable sales approach is not reliable in valuing subsidized housing, and that the income approach should be used instead (Ex. 34, p. 9-45; Ex. 36, pp. 352-53, 356; Ex. 54, pp. 2, 10, 13, 17; Ex. 55, p. 11; Ex. 56, p. 35; Furdek, R.40A, pp. 50-51, 58, 61) based on the subject property’s actual financial data, not market rates or estimates. (Ex. 34, p. 9-43; Ex. 54, pp. 14, 17; Ex. 55, pp. 11, 13; Ex. 56, pp. 37, 39; Furdek, R.40A, pp. 52, 57, 59-60.)

In addition to emphasizing their overall lack of competency in the field of subsidized housing, plaintiff’s post-trial filings detail numerous specific flaws in the Furdek/Weissenfluh appraisal of the subject property. (R.27; R.27A, R.30.) Inasmuch as the trial court’s Decision does not rely upon their appraisal in upholding the City’s 2012 and 2013 assessments, plaintiff will not repeat those criticisms here.

STANDARD OF REVIEW

The issues raised on appeal present legal questions that are reviewed *de novo*. In particular, the question whether an assessment complies with statutory requirements, including the WPAM, is a question of law reviewed independently. Allright Props., Inc. v. City of Milwaukee, 2009 WI App 46, ¶ 13, 317 Wis. 2d 228, 767 N.W.2d 567. Similarly, the propriety of an assessor's valuation methodology is a legal question reviewed *de novo*. Mineral Point Valley, 2004 WI App 158, ¶ 20; Soo Line R.R. Co. v. DOR, 97 Wis. 2d 56, 59-60, 292 N.W.2d 869, 871-72 (1980).

ARGUMENT

I. SPECIAL ASSESSMENT RULES APPLY TO SUBSIDIZED HOUSING.

Wis. Stat. § 70.32(1) requires assessors to value real property in the manner specified in the WPAM. The Supreme Court has reaffirmed that the WPAM controls, except to the extent it conflicts with governing law. Metro. Holding Co. v. Bd. of Review of Milwaukee, 173 Wis. 2d 626, 632-33, 495 N.W.2d 314, 317 (1993).

Section 70.32(1) sets forth a three-tier approach in valuing properties generally. The first priority is given to a recent sale of the subject property provided the sale was arms-length and conforms to sales of reasonably comparable properties. Where there is no recent sale of the subject, then the assessor is to “consider” recent arms-length sales of “reasonably

comparable” properties. In the absence of reasonably comparable sales, the assessor must use other generally accepted appraisal methods, i.e. the income or cost approach. This statutory framework is referred to as the “Markarian hierarchy,” referencing State ex rel. Markarian v. Cudahy, 45 Wis. 2d 683, 686-87, 173 N.W.2d 627, 629-30 (1970).

Notwithstanding the statutory preference for the comparable sales approach, it is not always permissible for an assessor to rely upon that approach. While § 70.32(1) requires an assessor to “consider” the comparable sales approach, both the statute and the WPAM require the availability of data on recent sales of “reasonably comparable” properties as a condition to actually *using* the comparable sales approach. “Reasonably comparable” means the properties are “similar to the subject property in age, condition, use, type of construction, location, design, physical features and economic characteristics.” (WPAM, Ex. 31, pp. 7-21 to 7-22, 9-10.) If the assessor does not have sufficient information to establish reasonable comparability, then the comparable sales approach may not be used in actually determining an assessment because the assessment must be based only on “reliable” valuation methodologies. (Ex. 33, p. 9-33.)

The WPAM requires an assessor to give primary emphasis to the valuation method upon which buyers and sellers in the market for the particular type of property rely in making real estate decisions. (Id.) The income valuation method is deemed the most reliable method for valuing

commercial property because it represents the way investors think when buying and selling rental property. (Id. at 9-12; see also Lerner, R.37, pp. 22, 208-11.)

The preferred method for determining the capitalization rate to use in applying the direct capitalization of income approach is the market derived method, i.e. determining a cap rate from recent market sales of *similar properties*. (Ex. 33, p. 9-24.) The assessor then adds the effective property tax rate to the market derived rate to arrive at the loaded cap rate. (Id. at 9-23.)

Beyond these general assessment principles, § 70.32, the WPAM, and case law also set forth specific directives to assessors with respect to assessing subsidized housing properties like the subject. For example:

- Section 70.32(1g) prohibits assessors from including the intangible value of the tax credits when assessing an IRC § 42 property.
- The WPAM requires that when considering the comparable sales approach, the assessor must understand the terms and conditions of the different federal subsidized housing programs described in the special section titled “Federally Subsidized Housing” and select as comparables only properties that have *similar restrictions* as the subject property. (Ex. 34, pp. 9-42, 9-45.)
- The WPAM also bars assessors from relying upon market rate properties as comparable sales when assessing a subsidized housing property, recognizing that subsidized housing properties have different operational constraints and risk factors and are therefore distinct from market rate projects. (Id. at 9-42.)
- The WPAM provides that, due to wide variations in the restrictions applicable to subsidized housing and the limited availability of data to establish the reasonable comparability of other sales, the

comparable sales approach typically is not a reliable method for assessing subsidized housing properties. Rather, the income approach is the most reliable and therefore the preferred method. (Id., p. 9-45.)

- When applying the income approach to the assessment of a subsidized housing property, the assessor must use the subject property's actual income and expenses, not market rates. Metro. Holding Co., 173 Wis. 2d at 634, 495 N.W.2d at 318 (1993); WPAM, Ex. 34, p. 9-43.

The Uniform Standards of Professional Appraisal Practice (“USPAP”), which apply to all appraisers including the City’s assessors (WPAM, Ex. 29, pp. 1-2 to 1-4), similarly recognize the unique considerations in valuing subsidized housing properties. USPAP specifies that appraising subsidized housing “requires knowledge and experience that goes beyond typical residential appraisal competency” and cautions that “[a]n appraiser’s lack of knowledge and understanding of the impact of the various influences that affect subsidized housing projects could lead to misleading conclusions.” (Ex. 38, p. A-30.)

II. THE TRIAL COURT ERRED IN CONCLUDING THAT THE HUD § 8 PROPERTIES AND MARKET RATE BUILDING THE ASSESSORS USED FOR THEIR COMPARABLE SALES APPROACH ARE “REASONABLY COMPARABLE” TO THE SUBJECT IRC § 42 PROPERTY.

As noted above, the assessors relied upon three “comparable sales” for purposes of their 2013 assessment. None of those sales satisfies even the most fundamental requirement of comparability with respect to physical

characteristics, unit mix, and location. Most glaringly, all three sales fail the test of comparability for subsidized housing projects in particular.

Two of the so-called comparable properties – Woodside Village/ Albert House, upon which the assessors placed primary reliance (Scites, R.39, pp. 37-38), and McMynn Tower – have no IRC § 42 restricted units at all, but rather consist entirely of rent-guaranteed units subsidized by the government under HUD § 8. (Ex. 12, pp. 9, 11.) Both the WPAM and the undisputed testimony of Lerner and McLaughlin establish that § 42 and § 8 are completely different programs which do not impose “similar restrictions.” (WPAM, Ex. 34, pp. 9-38 to 9-42; Lerner, R.37, pp. 128-31, 161-63, 166-208; McLaughlin, R.39, pp. 79-84.) As such, those sales fail the comparability requirement irrespective of their other features.

The third of the assessors’ comparable sales – Lake Oakes – consists predominantly of market rate apartments, with only a fraction of § 42 units. It violates the WPAM and accepted appraisal practices to use a predominantly market rate apartment building as a comparable sale when valuing a § 42 project. (WPAM, Ex. 34, p. 9-42; McLaughlin, R.38, p. 145.)

In upholding the assessors’ comparable sales valuation, the trial court’s Decision does not even acknowledge, much less purport to apply, the above legal authorities applicable to the comparable sales approach generally or with respect to subsidized housing in particular. Nor does the

Decision address the unrefuted testimony regarding the significant differences between § 42 and § 8 properties. Rather, the trial court merely concluded that because four “experienced” witnesses – the assessors and the City’s outside appraisers – testified that the assessors’ sales are comparable and that the comparable sales approach validly could be used in assessing plaintiff’s property, that was sufficient to uphold the assessors’ reliance upon the comparable sales approach. (Decision, R.31, pp. 7-8.)

While the City’s witnesses are experienced general assessors, they are not experienced when it comes to valuing subsidized housing. Neither of the assessors has ever developed, bought, sold or managed a subsidized housing project, nor do they have any special training on assessing subsidized housing. (Anderson, R.37, p. 5; Scites, R.39, p. 11.) They cannot, and did not purport to, refute the WPAM and the testimony of plaintiff’s witnesses regarding the significant differences between § 42 and § 8 restrictions and the lack of reliability of the comparable sales approach.

Similarly, while it is true that Furdek and Weissenfluh have 50 years’ of general assessment experience between them (Decision, R.31, pp. 7-8), neither has any experience whatsoever with respect to subsidized housing. Neither has ever developed, bought, sold or managed a subsidized housing project; neither has had any special training on valuing subsidized housing; and neither had ever valued a subsidized housing project until they were hired by the City to appraise the subject property. (Weissenfluh,

R.40A, pp. 147-48; Furdek, R.40A, pp. 31-37.) In fact, Furdek admitted he does not even know what restrictions apply to § 8 properties. (Furdek, id. at 46.)

Like the assessors, Furdek and Weissenfluh did not purport to opine that HUD § 8 and IRC § 42 impose “similar restrictions.” Indeed, before realizing that the comparable sales upon which he and Furdek relied in their appraisal included § 8 properties, Weissenfluh unequivocally testified that it would be improper to use § 8 properties as comparables in assessing a § 42 property. (Weissenfluh, R.40A, pp. 150-52.) After plaintiff pointed out Furdek and Weissenfluh’s comparable sales analysis relied upon § 8 properties, Furdek testified at trial – contrary to the governing WPAM – that differences in restrictions do not matter and do not have to be taken into consideration. (Furdek, R.40, pp. 37-38, 46-47, 101-03.)

In short, none of the City’s witnesses possesses either familiarity with the different subsidized housing programs or the “special competence” to value subsidized housing that USPAP requires. Their uninformed and conclusory opinions that differences in restrictions do not matter and that the comparable sales approach validly could be used to value plaintiff’s property cannot, and do not, trump the contrary legal requirements applicable to the assessment of subsidized housing properties. Hicks v. New York Fire Ins. Co., 266 Wis. 186, 189, 63 N.W.2d 59, 61 (1954) (reversing judgment where expert opinion was based on unwarranted

assumptions). As a matter of law, it was error for the assessors to rely upon § 8 and market rate properties in assessing plaintiff's § 42 property. It follows that the trial court's legal conclusion upholding the assessors' reliance upon the comparable sales approach must be reversed.

III. THE TRIAL COURT ERRED IN EXCUSING THE ASSESSORS' RELIANCE UPON A MARKET EXPENSE RATIO RATHER THAN PLAINTIFF'S ACTUAL EXPENSES.

Plaintiff argued below that the assessors' income valuations for the 2012 and 2013 assessments violated the WPAM and Wisconsin case law by using a so-called market expense ratio rather than plaintiff's specific expenses. The trial court's Decision acknowledges the legal requirement of using actual rather than estimated income and expenses in assessing subsidized housing projects. (Decision, R.31, p. 8, citing Metro. Holding Co., 173 Wis. 2d at 626; see also WPAM, Ex. 34, p. 9-43.)¹⁰ However, the Decision concludes the assessors' error did not matter because the assessments were based on the comparable sales approach, the validity of

¹⁰ The reason for requiring the use of actual rather than market rate income and expenses when valuing subsidized housing projects is that both income and expenses vary widely with subsidized projects, even among § 42 properties. Rental income depends on the number of bedrooms, the tenants' income levels, the set-asides dictated in the LURA, the applicable utility allowances, and whether all of the units are available for lease or some are provided rent-free to management staff. (Lerner, R.37, pp. 177, 179; R.38, pp. 3-4; McLaughlin, R.38, p. 104.) The variables that affect expenses for § 42 properties include whether they serve families or seniors, have common hallways or individual entrances, are high rises with elevators or garden level apartments, and are situated on small sites or large sites that require substantial mowing and plowing. (Lerner, R.37, pp. 189-90.) Since expense ratios are just a mathematical comparison of expenses to income, differences in either income or expenses will result in very different expense ratios, and it is therefore improper to apply the expense ratio of one property in valuing another. (McLaughlin, R.38, pp. 120, 123, 130, 210; Ex. 66.)

which was not affected by their reliance on a market expense ratio in their income approach used only as a cross-check. (Id. at 8-9.)

The trial court's rationale for excusing the assessor's erroneous reliance on a market expense ratio is faulty, for two reasons. First, the 2012 assessment was based exclusively on the assessors' income approach; the 2012 income approach was not merely a cross-check. (Ex. 11; Anderson, R.37, p. 16.) The validity of the 2012 assessment thus depends entirely on whether the assessor followed the law in applying the income approach. The Decision ignores this distinction in affirming *both* the 2012 and 2013 assessments based solely on the trial court's conclusion regarding the validity of the comparable sales approach. The assessors acknowledged at trial that the validity of the 2012 assessment depends on the propriety of utilizing a market expense ratio. (Scites, R.39, p. 49.) Reliance on market rate expenses clearly violates the WPAM and case law. Since the Decision acknowledges the assessors' income valuation violated the requirement of using actual expenses, and since the 2012 assessment was based solely on the income approach, it follows that the trial court's judgment must be reversed with respect to the 2012 assessment.

Second, for the reasons discussed above, the comparable sales approach could not validly be used in assessing the subject property in 2013 because none of the assessors' "comparable sales" satisfies the requirement of reasonable comparability. The validity of the 2013 assessment therefore

necessarily depends on the income approach. The assessors relied upon the same faulty assumptions for their 2013 income valuation as for the 2012 assessment. The trial court's judgment with respect to the 2013 assessment thus similarly must be reversed because the assessor violated the law by using a market expense ratio rather than plaintiff's actual expenses.

IV. THE TRIAL COURT ERRED IN EXCUSING THE ASSESSORS' FAILURE TO DERIVE A MARKET CAPITALIZATION RATE FROM SALES OF "SIMILAR PROPERTIES."

The assessors acknowledged at trial that the WPAM prefers "market derived" cap rates, and that is the method they purported to use in applying their 6% base cap rate. (Anderson, R.37, pp. 33-34.) The WPAM describes this method as determining a cap rate "from recent market sales of *similar properties*." (WPAM, Ex. 33, p. 9-24; emphasis added.) The assessors did not base their 6% base cap rate upon sales of other § 42 properties, however. Instead, they used a cap rate published by a brokerage house for newly constructed market rate apartment buildings that did not consider § 42 sales. (Anderson, R.37, p. 37-39; R.39, p. 68; Scites, R.39, p. 47; McLaughlin, R.40A, pp. 211-12.)¹¹

As Lerner and McLaughlin explained at trial, the market for § 42 properties is completely different from the market for market rate apartment

¹¹ Furdek and Weissenfluh similarly relied upon published cap rates for market rate apartment buildings as the source of their base cap rates (Ex. 119, pp. 53-55, 58; Furdek, R.40, pp. 78-79), which resulted in their loaded cap rates of 8.86% and 9.02% referenced in the trial court's Decision. (Decision, R.31, p. 10.)

buildings. There is virtually no market for newly constructed § 42 properties because the tax credits already have been sold, and after the credits expire on older properties, a buyer would still be subject to the LURA restrictions. Market rate apartment buildings, on the other hand, are not subject to any restrictions. (Lerner, R.37, pp. 185-86; McLaughlin, R.38, pp. 82, 105; R.40A, pp. 212, 264-65.) Moreover, the pool of potential § 42 tenants is much smaller than the pool of potential market rate tenants. (Ex. 27; Lerner, R.37, pp. 201-08; McLaughlin, R.38, p. 135.) As a result, there are greater risks with § 42 properties, which are reflected in higher cap rates than for market rate apartment buildings. (McLaughlin, R.38, p. 133.) As the WPAM recognizes, “[c]apitalization rates from the marketplace are usually derived from the sale of market-rate projects. Therefore they do not reflect the unique characteristics of subsidized housing.” (WPAM, Ex. 34, p. 9-45.)

As the trial court recognized, the cap rate has a huge impact on the value determination. The higher the cap rate, the lower the value. Slight differences in the cap rate can have a significant impact on the value. (Decision, R.31, p. 9.) The assessors’ reliance upon published cap rates for sales of market rate apartment buildings resulted in their applying a cap rate that was way too low and that inflated their assessments of the subject property. (McLaughlin, R.38, p. 140.)

In discussing the assessors' income valuation, the trial court's Decision correctly identifies plaintiff's challenge to the assessors' use of a capitalization rate derived from sales of market rate apartments rather than a rate derived from sales of apartments with restrictions similar to plaintiff's § 42 property. The Decision dismisses plaintiff's argument in one sentence, however, citing Mineral Point Valley for the proposition that "a capitalization rate based on [the] subsidized interest rate is impermissible, and . . . a market rate must be used." (Decision, R.31, p. 9.)

The trial court misapplied Mineral Point Valley. That case involved a HUD § 515 rural housing project for which the mortgage interest rate was subsidized by the government. The issue in the case was whether the subsidized interest rate or a market mortgage interest rate should be used in determining the appropriate cap rate. The reason the mortgage interest rate was relevant to the cap rate determination in Mineral Point Valley is that the cap rate was determined via the "band of investment" method, not the market derived method. 2004 WI App 158, ¶ 7 (referring to the cap rate as including a mortgage rate, which describes the band of investment method); see also Bloomer Hous. Ltd. P'ship v. City of Bloomer, 2002 WI App 252, ¶ 16, 257 Wis. 2d 883, 653 N.W.2d 309 (discussing cap rate for § 515 project and citing the band of investment discussion in the WPAM). As the WPAM explains, "the band of investment method (mortgage equity method) can be beneficial to use if the interest rate on the existing mortgage

on the property is different from current market level interest rates.”
(WPAM, Ex. 33, p. 9-26.)

In this case, both the assessors and plaintiff’s expert used the market derived method of determining the cap rate for their income valuations, not the band of investment method. The market derived method has nothing to do with mortgage interest rates. Rather, a market derived cap rate is determined by finding sales of similar properties and dividing the NOIs for those properties by their sale prices. (WPAM, Ex. 33, p. 9-24.) Mineral Point Valley therefore is not relevant to the question of the appropriate cap rate in this case and certainly does not undermine the WPAM’s requirement of basing a market derived cap rate on sales of “similar properties.” The trial court therefore erred in upholding the assessors’ cap rate.

V. THE TRIAL COURT ERRED IN RULING THAT PLAINTIFF’S EXPERT VIOLATED THE MARKARIAN HIERARCHY BY RELYING SOLELY UPON THE INCOME APPROACH.

Plaintiff’s expert, McLaughlin, has specialized in appraising subsidized housing projects, including § 42 properties, for over 25 years. Unlike the City’s experts, who never appraised a subsidized housing project in their lives prior to their work in this case, McLaughlin has appraised literally hundreds of such properties. (Ex. 39; McLaughlin, R.38, p. 76.) Based on his extensive experience, McLaughlin opined in his report and at trial that the appropriate valuation method for such properties, and the

method on which buyers and sellers rely, is the capitalized income approach. (Ex. 40, p. 1, ¶ 4; McLaughlin, R.38, pp. 80, 108.) He explained that, while it is theoretically possible to use the comparable sales approach if data were available establishing that other § 42 properties have restrictions similar to the property being appraised, such data was not available here, without which the comparable sales approach cannot be applied reliably. He therefore relied solely upon the income approach in appraising the subject property. (McLaughlin, id. at 212-14.)

McLaughlin's conclusion that the income approach is the only reliable approach to use in valuing plaintiff's § 42 property complies with the WPAM. While the WPAM suggests appraisers should "consider" all three appraisal approaches – comparable sales, income and cost – it also acknowledges there may not be sufficient data to support a reliable analysis under each approach, and assessors are barred from using valuation methods that are not reliable. (WPAM, Ex. 33, p. 9-33.) According to the WPAM:

The assessor can employ only those approaches to value for which there is adequate data to develop an opinion of value. ***If*** more than one approach is developed in the appraisal, the individual value estimates must be reconciled . . .

The final value estimate ***may be the value estimate derived from one of the approaches***

(WPAM, Ex. 34, p. 7-21; emphasis added.)

The WPAM specifically recognizes the difficulty of obtaining data establishing that other subsidized properties have restrictions similar to the subject, in the absence of which the comparable sales approach may not be used. (Ex. 34, p. 9-45.) It also specifies that the cost approach is not reliable. (Id.) The WPAM directs that the income method is the most reliable method for valuing commercial properties in general and subsidized housing properties in particular. (Ex. 33, p. 9-12; Ex. 34, p. 9-45.) The WPAM thus endorses reliance solely on the income approach when valuing subsidized housing properties.

The trial court nevertheless ruled that McLaughlin's sole reliance on the income method violated Wisconsin law, citing Bischoff v. Appleton, 81 Wis. 2d 612, 260 N.W.2d 773 (1978). (Decision, R.31, p. 10.) Bischoff has nothing to do with subsidized housing. That case involved the assessment of a market rate property purchased by the plaintiff in an arms-length transaction for \$448,000, which the City of Appleton assessed at \$858,200 applying the income approach. The court stated that where a fair market sale of the subject has occurred, it is error to consider other evidence of value, especially solely the income. Id. at 619, 260 N.W.2d at 776. Bischoff thus illustrates the first tier of the Markarian hierarchy, i.e. that a recent sale of the subject in an arms-length transaction is determinative as to value.

Nothing in Bischoff undermines the WPAM’s directive to use the income approach in appraising subsidized housing when there has been no sale of the subject and there is insufficient information to establish reasonably comparable sales. In Adams Outdoor Adver., Ltd. v. City of Madison, 2006 WI 104, ¶ 53, 294 Wis. 2d 441, 717 N.W.2d 803 (emphasis added), the Supreme Court specifically recognized:

There may be situations in which the only information available compels an assessor to use a *single methodology* to assess property. . . . The Property Assessment Manual directs appraisers to use the assessment methodology or methodologies that are the most reliable.

Adams puts the Bischoff rule in context, explaining that “[w]here there is sufficient data to estimate market value under both the income and cost approaches,” assessors may not rely solely upon the income approach. Id. ¶¶ 54-55. In other words, the prohibition against sole reliance on the income method only applies if there are other reliable methods. That observation does not alter the conclusion that where, as here, there is *not* sufficient information reliably to apply the comparable sales and cost approaches, the value must be determined solely on the basis of the income approach.

Indeed, sole reliance on the income approach for subsidized housing valuations repeatedly has been upheld by Wisconsin appellate courts. Metro. Holding Co., 173 Wis. 2d at 629, 495 N.W.2d at 315 (capitalization of income approach used to value HUD restricted senior housing project);

Bloomer Hous. Ltd. P'ship, 2002 WI App 252, ¶ 15 (income approach was proper method to value HUD § 515 property); Mineral Point Valley, 2004 WI App 158, ¶ 7 (same); Northland Whitehall Apts. Ltd P'Ship v. City of Whitehall Bd. of Review, 2006 WI App 60, ¶¶ 5, 10, 18-19, 25, 290 Wis. 2d 488, 713 N.W.2d 646 (rejecting assessor's reliance on comparable sales approach to value HUD § 515 property and citing the WPAM's endorsement of the income approach as "the most useful and often *the only method* for valuing subsidized housing").

The trial court ignored these legal authorities when it concluded McLaughlin's sole reliance on the income approach violated Wisconsin law. The court also applied a double standard, upholding the assessors' 2012 assessment that was based solely on the income approach, yet rejecting McLaughlin's appraisals because they were based solely on the income approach.

When the comparable sales approach is not reliable for valuing subsidized housing, and when assessors are barred from utilizing unreliable methods, it follows that a subsidized housing valuation necessarily must be based solely upon the income method.¹² The trial court therefore erred in concluding McLaughlin's appraisals violated Wisconsin law by relying solely on the income approach.

¹² The assessors and McLaughlin agree the cost approach is not a reliable method for valuing subsidized housing. (WPAM, Ex. 34, p. 9-45; Anderson, R.37, pp. 48-51; R.40, ¶ 5; McLaughlin, R.38, p. 107.)

VI. THE TRIAL COURT ERRED IN CONCLUDING THAT PLAINTIFF'S EXPERT FAILED TO FOLLOW THE STEPS IN THE WPAM FOR VALUING SUBSIDIZED HOUSING.

The trial court's Decision summarizes as follows the steps for applying the direct capitalization of income valuation method set forth in the WPAM:

(1) Estimating potential gross income; (2) deducting for vacancy and collection loss; (3) adding miscellaneous income; (4) determining operating expenses; (5) subtracting operating expenses to derive net income; (6) selecting the correct capitalization method; (7) deriving the capitalization rate; and (8) applying the capitalization rate to net income to arrive at a value estimate.

(Decision, R.31, p. 5; WPAM, Ex. 33, p. 9-13.) McLaughlin's income valuations complied with these steps. (Ex. 40, pp. 3-4; McLaughlin, R.38, pp. 111-39.)

The Decision also references the WPAM's "detailed, step-by-step method for assessing federally subsidized housing" and concludes McLaughlin failed to apply those steps. (Decision, R.31, p. 10, citing WPAM, Ex. 34, pp. 9-41 to 9-45.) The Decision fails to identify in what respect McLaughlin allegedly failed to comply with the WPAM.

The WPAM section referenced in the Decision describes the following steps as guidelines for valuing federally subsidized properties: (1) determine the program that regulates the property; (2) learn the terms and conditions of that particular program by, among other things, obtaining the regulatory agreement; (3) identify the primary ownership interests; (4) determine the assessable interest based on the ownership type and

applicable statutes and case law; (5) determine the property's highest and best use; and (6) determine "the" proper method for valuing the subsidized property. (Ex. 34, pp. 9-42 to 9-45.) Unlike the assessors, McLaughlin followed all of those steps. In particular, he determined that the subject property was an IRC § 42 property, and he studied the specific restrictions applicable to the property by obtaining and reviewing its LURA. (McLaughlin, R.38, pp. 106, 111-12.) He concluded that the highest and best use of the property is its current use as a low income housing development, he determined that the proper method for valuing such a property is the direct capitalization of income method, and he applied that method. (Id. at 79, 101, 111; Ex. 40.)

The only errors of which the Decision accuses McLaughlin are failing to follow the Markarian hierarchy, and "appl[ying] a subsidized interest rate, rather than the market mortgage interest rate, to his income approach calculation." (Decision, R.31, pp. 10, 11.) Section V above responds to the Court's legal conclusion regarding the Markarian hierarchy. Wis. Stat. § 70.32(1) and the WPAM only require "consideration" of the comparable sales approach; they do permit, much less require, the use of that method when, as here, evidence of reasonably comparable sales is not available.

The trial court's criticism of McLaughlin for supposedly applying a "subsidized interest rate" relates to the discussion in Section IV above. As

noted there, this case has nothing to do with interest rates. Like the assessors, McLaughlin used the market derived method of determining his cap rate, not the band of investment method. Unlike the assessors, McLaughlin followed the WPAM's requirement of deriving his cap rate from sales of similar properties, i.e. other § 42 properties, rather than from sales of market rate apartment buildings. In so doing, he did not purport to apply a "subsidized interest rate," or any other interest rate, as the trial court suggested.

Rather, based on his knowledge and experience with subsidized housing, McLaughlin identified six sales of § 42 family properties over the period August 2010 to August 2011, with cap rates ranging from 6.6% to 8.8%. (Ex. 46; McLaughlin, R.38, p. 133.) Based on that market derived data from sales of similar properties, and considering the higher degree of risk associated with a start-up development, he applied a base cap rate of 8.0% for 2012 and a base rate of 7.6% for 2013. Adding the same property tax rates used by the assessors, his loaded cap rates were 10.547% for 2012 and 10.447% for 2013. (Ex. 40; McLaughlin, R.38, pp. 133, 137-39.)

McLaughlin's evidence of market derived cap rates from sales of other § 42 properties is unrefuted. His reliance on such market derived cap rates from sales of similar properties complied with WPAM. There is no basis for the trial court's conclusion that McLaughlin's cap rate was based

on a “subsidized interest rate” or that it failed to comply with Wisconsin law.

VII. THE TRIAL COURT ERRED IN CONCLUDING THAT PLAINTIFF FAILED TO OVERCOME THE PRESUMPTION OF CORRECTNESS OF THE 2012 AND 2013 ASSESSMENTS.

Property tax assessments generally are presumed correct. Wis. Stat. § 70.49(2). The presumption of correctness does not apply, however, under either of two circumstances: (1) the taxpayer presents “significant contrary evidence,” or (2) the taxpayer shows that the assessment violates the WPAM. Bonstores Realty One, LLC v. City of Wauwatosa, 2013 Wis. App 131, ¶ 5, 351 Wis. 2d 439, 839 N.W.2d 893; Allright Props. v. City of Milwaukee, 2009 WI App 46, ¶ 12, 317 Wis. 2d 228, 767 N.W.2d 567. Contrary to the trial court’s conclusion, plaintiff satisfied both conditions here.

First, as discussed above, plaintiff demonstrated that the 2012 and 2013 assessments violate the WPAM. The 2012 assessment, based solely on the income method, violated the WPAM and controlling case law by (1) using an estimated market expense ratio rather than plaintiff’s actual expenses, and (2) applying a capitalization rate derived from sales of market rate apartment buildings rather than sales of similar properties. The 2013 assessment, based on the comparable sales approach, violated the WPAM by, among other things, using sales of HUD § 8 properties and a

predominantly market rate apartment building as “comparable sales,” none of which had restrictions similar to plaintiff’s § 42 property. Further, to the extent the assessors relied upon the income approach in 2013, their methodology repeated the WPAM violations from their 2012 assessment.

Second, plaintiff presented significant contrary evidence demonstrating that the 2012 and 2013 assessments are excessive. Plaintiff established that plaintiff’s expenses were much higher than \$250,000, which the assessors assumed by applying their 40% expense ratio. Plaintiff’s projections that would have been available to a prospective buyer as of January 1, 2012 showed operating expenses of \$308,840, a ratio of 52% of revenues. (Ex. 40, p. 3.) Plaintiff’s audited year-end 2012 financial statements that would have been available to a prospective buyer as of January 1, 2013 showed operating expenses of \$332,860, a ratio of 53.8% of revenues. (Id. at 4.) The assessors’ improper reliance upon a 40% expense ratio rather than plaintiff’s specific expenses alone inflated the assessments by over \$1 million. (McLaughlin, R.38, pp. 123, 130, 160.)

Plaintiff also presented significant contrary evidence demonstrating that the assessors’ 6% base cap rate was too low. The assessors acknowledged that rate came from sales of market rate apartment buildings that did not include any § 42 sales. In contrast, McLaughlin’s unrefuted data on sales of § 42 family properties substantiate market derived base cap rates from sales of similar properties ranging up to 8.8%. (Ex. 42.) The

assessors' understatement of the cap rate further inflated the assessments.
(Ex. 40, ¶ 9.)

Unlike the assessors, McLaughlin is eminently qualified to appraise plaintiff's § 42 property and did so by the book, complying with the WPAM, Wisconsin law, and generally accepted appraisal practices in all respects. His assessor report card (Ex. 37), appraisals (Ex. 40) and testimony constitute significant contrary evidence demonstrating that the 2012 and 2013 assessments are excessive, and that the correct market values are \$2,700,000 and \$2,730,000, respectively. It was error for the trial court to reject such competent evidence in holding that plaintiff failed to overcome the presumption of correctness. Steenberg v. Oakfield, 167 Wis. 2d 566, 572, 482 N.W.2d 326, 328 (1992) (citing principle and reversing Court of Appeals decision upholding assessment where property owner overcame presumption of correctness through evidence the assessment exceeded recent arm's-length purchase price).

CONCLUSION

The trial court's Decision and judgment are premised upon erroneous legal conclusions regarding both the validity of the 2012 and 2013 assessments and the propriety of McLaughlin's appraisals. When those errors are corrected, it is readily apparent that the assessments are contrary to the WPAM and other Wisconsin law, and that plaintiff

presented significant contrary evidence establishing that the assessments are excessive.

For all of the foregoing reasons, plaintiff respectfully requests that the Court reverse the trial court's judgment, determine that the 2012 and 2013 assessments should have been \$2,700,000 and \$2,730,000, respectively, and direct the entry of judgment in plaintiff's favor accordingly.

Dated this 6th day of February, 2015.

Respectfully submitted,

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FORM AND LENGTH CERTIFICATION

I certify that this brief conforms to the rules contained in § 809.19(8)(b) for a brief produced using proportional serif font. The length of this brief is 10,897 words.

Dated this 6th day of February, 2015.

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APPENDIX CERTIFICATION

I hereby certify that filed with this Brief, either as a separate document or as a part of this brief, is an appendix that complies with sec. 809.19(2)(a) and that contains, at a minimum, (1) a table of contents, (2) the findings or opinion of the circuit court, and (3) portions of the record essential to an understanding of the issues raised, including oral or written rulings or decisions showing the circuit court's reasoning regarding those issues.

I further certify that if this appeal is taken from a circuit court order or judgment entered in a judicial review of an administrative decision, the appendix contains the findings of fact and conclusions of law, if any, and final decision of the administrative agency.

I further certify that if the record is required by law to be confidential, the portions of the record included in the appendix are reproduced using first names and last initials instead of full names of persons, specifically including juveniles and parents of juveniles, with a

notation that the portions of the record have been so reproduced to preserve confidentiality and with appropriate references to the record.

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E-FILING CERTIFICATION

Pursuant to Wis. Stat. § 809.19(12)(f), I hereby certify that the text of the electronic copies of Appellant's Brief and Appendix are identical to the text of the paper copies.

Dated this 6th day of February, 2015.

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CERTIFICATE OF MAILING

I certify that Appellant's Brief and Appendix was deposited in the United States mail for delivery to the Clerk of the Court of Appeals by first-class or priority mail, or other class of mail that is at least as expeditious, on February 6, 2015. I further certify that the Brief and Appendix was correctly addressed and postage was pre-paid.

Dated this 6th day of February, 2015.

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