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STATE OF WISCONSIN
SUPREME COURT

REGENCY WEST APARTMENTS LLC,

Plaintiff-Appellant-Petitioner,

v. Appeal No. 2014AP002947

CITY OF RACINE,

Defendant-Respondent.

On Review of a Decision of the
Court of Appeals, District II
Appeal from Circuit Court of Racine County
The Honorable Gerald P. Ptacek, Presiding
Trial Court Nos. 13-CV-1546 and 13-CV-1848

PETITIONER'S BRIEF

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INTRODUCTION

This appeal presents critical questions about the appropriate methodology for assessing low income housing developments.

The property at issue is an IRC § 42[1] low income housing tax credit development in Racine (the "subject property") owned by plaintiff-appellant-petitioner Regency West Apartments LLC ("Regency West"). IRC § 42 is a U.S. Treasury program that incentivizes developers to invest in 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 at lower rates (although not reducing the operating expenses).

IRC § 42 is one of ten (10) different federal government housing programs discussed in the Wisconsin Property Assessors Manual ("WPAM") published by the Wisconsin Department of Revenue. Wis. Stat. § 70.32(1) requires assessors to comply with the WPAM. The WPAM contains a special section titled "Federally Subsidized Housing" that describes the differences among the various federal housing programs and sets forth special requirements for the assessment of properties subject to such programs. The WPAM provides that (1) only subsidized housing properties with "similar restrictions" may be used in applying the comparable sales approach; (2) assessors may not rely upon market rate properties when assessing a subsidized housing property; (3) because

[1] 26 U.S.C. § 42.

information on the specific restrictions applicable to other subsidized housing properties is not readily available, the comparable sales approach is not a reliable assessment method; the income approach should be used instead; and (4) when applying the income approach, the assessor must use the subject's actual income and expenses, not market rates, and derive capitalization ("cap") rates from sales of "similar" properties. (Ex. 34, pp. 9-42, 9-43, 9-45; Ex. 33, p. 9-24.)[2]

The assessors for the City of Racine ("City") altogether ignored these special WPAM requirements. They used a market rate apartment building and HUD § 8 properties – which have different restrictions and benefit from true government rent subsidies – as so-called comparable sales in valuing the subject property under the comparable sales approach. They also violated Wisconsin law in applying their income approach by using market rate expenses and a market cap rate rather than expenses specific to the subject property and a cap rate derived from sales of § 42 properties. Consequently, they grossly over-assessed the subject property, arriving at values of $4,425,000 and $4,169,000 for the years 2012 and 2013, respectively, whereas application of the correct methodology results in values of $2,700,000 and $2,730,000.

[2] Except as otherwise noted, record cites in this brief refer to the record on appeal in Case No. 13-CV-1546. Trial exhibits are included in R.42 and R.43 and are referenced herein as "Ex. ___." 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. Appendix items are cited as "App. ___."

The resulting excessive property taxes assessed by the City have continued, and will continue indefinitely, unless and until the City is forced to bring its assessment methodology into compliance with the WPAM. Such excessive taxes threaten the very viability of this housing development. That is because low income housing projects operate under very tight budgets, and applicable regulations do not give Regency West the option to raise rents to cover the difference between the taxes projected when this project was developed, underwritten, and approved by regulators and the taxes as assessed by the City.

The trial court's and court of appeals' acceptance of the City's excessive assessments demonstrates the need for clarification of the law applicable to the assessment of low income housing developments. Regency West respectfully requests that this Court reverse the court of appeals decision, order judgment for Regency West, and provide guidance to assessors by holding that:

(1) HUD § 8[3] rent subsidized properties are not "reasonably comparable" to IRC § 42 low income housing tax credit properties and may not be used in applying the comparable sales approach to value § 42 properties;

(2) Except in rare circumstances not present here, assessments of subsidized housing must be based solely on the income approach;

[3] 42 U.S.C. § 1437f.

(3) In applying the income method to value a newly constructed subsidized housing project, the appropriate substitute for prior year financial statements to determine actual expenses are projected expenses for the subject property as of the assessment date; market rate expenses may not be used; and

(4) In applying the market derived method to determine the cap rate for valuing a subsidized housing project, only sales of the same classification of subsidized housing may be considered, not sales of market rate properties.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Do sales of HUD § 8 rent subsidized properties constitute "reasonably comparable" sales of properties with "similar restrictions" for purposes of applying the comparable sales approach to assess an IRC § 42 low income housing tax credit property?

The trial court ignored the WPAM requirement that only properties with ***"similar restrictions***" may be considered as comparable in assessing subsidized housing, ignored the undisputed evidence regarding material differences between HUD § 8 and IRC § 42 restrictions, and accepted the assessors' § 8 sales as reasonably comparable to the subject § 42 property.

The court of appeals concluded it was appropriate for the assessors to rely upon § 8 sales in assessing the subject § 42 property because (a) the WPAM discusses the various federal housing programs in the same special

section, and (b) the assessors opined that the ***rents*** (not the ***restrictions)*** for the § 8 sales were similar to the subject property.

2. Did the assessors' income valuations violate the WPAM and Wisconsin law by utilizing a market expense ratio rather than the subject property's projected and actual expenses?

The trial court acknowledged that the assessors violated Wisconsin law in using a market expense ratio rather than Regency West's specific 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, ignoring that the 2012 assessment was based solely on the income approach and that the comparable sales approach was not a valid methodology for 2013.

The court of appeals similarly excused the assessors' improper reliance on a market expense ratio for 2013 as immaterial in light of their reliance on the comparable sales approach. For the 2012 assessment, the court of appeals suggested it was reasonable for the assessors to use a market expense ratio because Regency West did not have a full year of actual operating expenses available as of the assessment date.

3. Did the assessors' income valuations violate the WPAM by utilizing a cap rate derived from sales of market rate apartment buildings rather than from sales of other § 42 properties?

The trial court upheld the assessors' cap 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, a case involving subsidized interest rates under HUD § 515[4] for which the capitalization rate was determined using the band of investment method, not the market derived method purportedly used by the assessors.

The court of appeals recognized the trial court erred in relying on Mineral Point but nevertheless justified the assessors' cap rate, erroneously suggesting their cap rate source included § 42 properties.

4. Is it appropriate to rely solely upon the income approach in valuing subsidized housing projects for property tax assessment purposes?

The trial court held that Regency West failed to overcome the presumption of correctness of the 2012 and 2013 assessments because its expert relied solely on the income approach rather than utilizing the comparable sales approach, which the court ruled violated the Markarian hierarchy.[5]

The court of appeals concurred with the trial court.

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[4] 42 U.S.C. § 1485.

[5] State *ex rel*. Markarian v. Cudahy, 45 Wis. 2d 683, 173 N.W.2d 627 (1970).

STATEMENT ON ORAL ARGUMENT AND PUBLICATION

Regency West 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, the first year after completion of construction of Regency West's § 42 housing development. Regency West filed a claim for excessive assessment,[6] which the City denied. Regency West 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.)

The City assessed the subject property at $4,169,000 as of January 1, 2013. Regency West exhausted board of review procedures and filed a timely claim for excessive assessment, which the City denied. Regency West then filed a § 74.37(3)(d) refund action, Case No. 13-CV-1848 ("the 2013 action"). (Case No. 13-CV-1848, R.2.)

[6] The trial court ruled Regency West was not obligated to exhaust board of review procedures for the 2012 assessment because it did not receive a 2012 assessment notice. (R.15.) The City did not cross-appeal to challenge that order.

The trial court consolidated the 2012 and 2013 actions for trial. (R.17.) At trial, Regency West presented the testimony of 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.) It also presented the testimony of its appraiser, 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, Janet Scites and Ray Anderson, 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; Furdek, R.45, pp. 31-36; Weissenfluh, id. at 31-37.)

Following post-trial briefing (R.27, R.27A, R.28, R.29, R.30), the trial court issued its decision on November 4, 2014. (R.31; App. 10.) The court ruled that Regency West 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. It was appropriate for the assessors to rely upon HUD § 8 and market rate properties for their comparable sales approach. (Id. at App. 17.)

2. The assessors' erroneous use of a market expense ratio rather than Regency West's actual expenses for their income approach was immaterial because the 2013 assessment was based on the comparable sales approach. (Id. at App. 17-18.)

3. The assessors' reliance on a cap rate derived from sales of market rate apartments rather than sales of § 42 properties was proper under Mineral Point Valley, 2004 WI App. 158. (Id. at App. 18.)

4. McLaughlin violated the Markarian hierarchy and Bischoff v. Appleton, 81 Wis. 2d 612, 260 N.W.2d 773 (1978) by relying solely on the income approach. (Id. at App. 19-20.)

The trial court entered judgment for the City on November 20, 2014. (R.33, App. 22.) Regency West timely appealed. (R.36.)

The court of appeals affirmed in a per curiam decision issued September 16, 2015. It upheld the trial court's judgment on the grounds that: (1) the WPAM does not preclude the use of HUD § 8 properties as comparisons in assessing an IRC § 42 property; (2) it was appropriate for the City's assessors to utilize § 8 properties as comparable sales because they testified the rents were similar to the subject § 42 property's rents; (3) the errors in the assessors' income approach were immaterial; and (4) the trial court reasonably discredited the testimony of Regency West's expert because he relied solely on the income approach. (Slip op. ¶¶ 15, 18-21, App. 6-9.)

B. Statement of Facts

1. IRC § 42 versus HUD § 8

The WPAM recognizes the unique challenges in valuing various types of low income housing developments subject to different federal assistance programs. It describes 10 such programs involving mortgage insurance, mortgage interest reduction, income tax credits, or rent subsidies. (Ex. 34, pp. 9-38 to 9-42.) The WPAM uses the term "federally subsidized housing" as a short-hand to describe all of these programs, although IRC § 42 does not involve a subsidy of any type.

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 Authority ("WHEDA"). (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. "Set-asides" are tenant income restrictions expressed as a percentage of county median income ("CMI"). 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. (Ex. 34, p. 9-40; Lerner, R.37, pp. 168, 170-71, 173, 183-84.)

WHEDA publishes the maximum rents that may be charged to § 42 tenants at different CMI levels. (Ex. 24.) There are no rent subsidies and no guarantees that owners can actually charge maximum allowable rents; that depends on what the market will bear. Nor are there any 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 about 12-14% 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 extensive verification procedures.

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. That means identical § 42 project configurations may generate very different revenues depending on where they are located. (Lerner, R.45, 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.45, 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

Unlike 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, with the government paying rents or debt service for extended periods. 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.) The § 8 program is no longer available for new developments, and scarcity makes it a seller's market for these properties. (McLaughlin, R.38, p. 81.)

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. The project is situated on 7 acres of land located just west of the vacant Sam's Club and south of the City dump. (Lerner, R.37, at 164-65, 253-56.)

All 72 apartment units in the subject property are income and rent restricted. Under Regency West'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 employees. (Id. at 127, 170; Lerner, R.38, pp. 3-4.) 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

Neither of the City's assessors has any personal experience with subsidized housing, nor have they had any special training on assessing subsidized housing. (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 property's net operating income ("NOI") into an estimate of value by dividing the NOI (income less expenses) by the applicable cap rate. (Ex. 33, pp. 9-13, 9-21.) The 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, Regency West had only been operating for a couple of months and did not yet have audited financial statements available. However, as of that time its actual rents were known, and its expenses had been projected consistently, and independently, by four different sources, including WHEDA. (Ex. 42; Lerner, R.37, pp. 212-31, 241-42; R.38, pp. 10, 49.)

For purposes of the 2012 assessment, the assessors accepted the estimates of potential gross income and vacancy rate in a prospective appraisal commissioned in 2010 by Regency West's construction lender. (Ex. 11; Ex. 13; Anderson, R.37, pp. 23, 28-30; Lerner, id. at 235.)

However, they rejected the expense projections in that same appraisal as supposedly too high in comparison to other § 42 properties (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 expenses specific to the subject property, the assessors applied a 40% estimated expense ratio supposedly based on other § 42 properties.[7] (R.11; Anderson, R.37, pp. 25, 27-28, 30; Scites, R.39, p. 5.) As a result of understating Regency West's expenses, the assessors computed an NOI 37% higher than the prospective appraisal. (Ex. 11; Anderson, R.37, pp. 29-33.)

The assessors purported to apply a market derived cap rate, the method preferred by WPAM. (Ex. 33, p. 9-24; Anderson, R.37, pp. 33-34.) Although the WPAM dictates the use of cap rates derived from sales of "similar properties" (Ex. 33, p. 9-24), the assessors derived their 6.0% base cap rate from sales of market rate apartments, 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.)[8] Dividing their NOI by their loaded cap rate, the assessors arrived at a value

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

[8] The WPAM directs assessors to "load" the base cap rate by adding the property tax rate. (Ex. 33, p. 9-23.)

of the subject property of $4,425,000 for 2012 (Ex. 11), as compared with the prospective appraisal of $2,600,000. (Ex. 13, p. 60.)

4. The 2013 Assessment

The assessors based the 2013 assessment of the subject property upon the comparable sales approach. (R.12; Anderson, R.37, p. 56; Scites, R.39, p. 9.) Under this approach, an assessor is obligated to find a pool of arm's-length sales that are "reasonably comparable" to the property being assessed, i.e. similar in age, condition, location, use, type of construction, design, physical features, and economic characteristics. After verifying that the comparison properties meet the test of reasonable comparability, the assessor makes positive or negative adjustments to the sale prices of the comparison properties to reflect differences between those properties and the property being assessed, as supported by market data. (Ex. 31, pp. 7-22, 8-5; Anderson, R.37, pp. 58-64.)

For purposes of their comparable sales approach, the assessors relied upon three so-called "comparable sales": (1) Woodside Village/Albert House, (2) Lake Oakes, and (3) McMynn Tower. (Ex. 12; Anderson, R.37, p. 69.) In addition to material differences in physical attributes and location (Lerner, R.37, pp. 164-65, 253-56; McLaughlin, R.38, pp. 145-47), the key characteristics of the assessors' comparison sales as contrasted to the subject property are summarized as follows:

	Subject	Woodside/ Albert	Lake Oakes	McMynn
Bedroom mix	36 2-BR 36 3-BR	Mostly 1-BR	1-BR and 2-BR	All 1-BR
Tenant type	All family	50 family 104 senior	Primarily senior	All senior
Federal program	All IRC § 42	All HUD § 8	A few IRC § 42 units; predominantly market rate	All HUD § 8
Tenant income restrictions	51 ≤ 50% CMI 21 ≤ 60% CMI	All ≤ 80% CMI	N/A to market rate units	All ≤ 80% CMI
Govt. rent subsidies	None	Amount above 30% of tenant income	None	Amount above 30% of tenant income
Commercial use	None	None	None	Accounts for 8-10% of income

(Ex. 12, pp. 9-11; Lerner, R.37, pp. 254-56; McLaughlin, R.38, pp. 145, 147; Scites, R.39, pp. 33, 36; Ex. 61.)

In applying the comparable sales approach for their 2013 assessment, the assessors did not even attempt to obtain, much less actually consider, the agreements setting forth the specific restrictions applicable to their comparison properties, as required by the WPAM. (Ex. 34, p. 9-45.) Rather, they simply assumed that § 42 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; contra Lerner, R.37, p. 186-87; R.38, p. 8.)

The assessors placed primary reliance on the Woodside Village/Albert House § 8 sale and arrived at a value of $4,169,000 for the subject property under their comparable sales approach. They admitted the

validity of the 2013 assessment depends on the propriety of treating § 8 and § 42 properties as reasonably comparable. (Ex. 12, p. 3; Anderson, R.37, p. 88; Scites, R.39, pp. 37-38.)

The assessors performed an income valuation as a cross-check for their 2013 comparable sales approach, using the same assumptions as for their 2012 income valuation. (Anderson, R.37, pp. 52-54.) They continued to rely upon their 40% market expense ratio even though they possessed Regency West's year-end 2012 audited financial statements establishing much higher actual expenses and had no basis to dispute those financials. (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 assessors' income approach suggested a value of $4,129,000.

The assessors also purported to conduct a cost of construction analysis as a third approach in their 2013 assessment report. (Ex. 12.) They did not exclude the value of the tax credits and did not factor in economic or external obsolescence to account for the restrictions, as the WPAM requires. (Ex. 34, pp. 9-40, 9-45.) The assessors recognized their cost approach was unreliable and did not use it in establishing or supporting the 2013 assessment. (Anderson, R.37, pp. 48-51; Scites, R.38, p. 251.) Rather, based on their comparable sales approach, they 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. Regency West's Expert's Opinions

Regency West'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, investors and WHEDA over the past 25 years. (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 Regency West'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; Ex. 47; McLaughlin, R.38, pp. 101-07, 141-47, 151-59, 193, 215.)

In addition to critiquing the assessments, McLaughlin independently appraised the subject property as of January 1, 2012 and January 1, 2013. He did not apply the comparable sales approach because he was unable to obtain data on other § 42 properties' specific set-asides and other restrictions, without which a reliable comparable sales analysis cannot be performed. Instead, he relied solely upon the 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 used Regency West's 2012 projections prepared in November of 2011, which were consistent with projections specific to the subject property independently prepared by three other sources, including WHEDA. (Ex. 42; McLaughlin, R.45, pp. 244-45; Lerner, R.37, p. 242; R.45, p. 172.) For his January 1, 2013 valuation, McLaughlin relied upon audited financial statements for the year ending December 31, 2012. (Ex. 40; Ex. 43; Ex. 44; McLaughlin, R.45, p. 245; Lerner, R.37, p. 249.)

To determine the applicable cap rate, McLaughlin analyzed cap rate data from sales of other § 42 properties. (Ex. 46; McLaughlin, R.45, pp. 213-14.) Based on that market derived data, he applied base cap rates of 8.0% for 2012 and 7.6% for 2013. (McLaughlin, R.45, 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 general assessors with no experience 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.45, pp. 31-36; Weissenfluh, R.45, 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.45, p. 37; Weissenfluh, id. at 148-49.)

Notwithstanding their review for purposes of this case of subsidized housing valuation resources that caution § 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 and Weissenfluh concluded there is nothing complicated about appraising a § 42 property, and they did not do anything differently in appraising the subject property than they would do in appraising any other commercial property. (Furdek, R.45, pp. 37-38, 42, 48.)

STANDARD OF REVIEW

The issues raised in this 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; Adams Outdoor Advert., Ltd. v. City of Madison, 2006 WI 104, ¶ 26, 294 Wis. 2d 441, 717 N.W.2d 803. 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. v. DOR, 97 Wis. 2d 56, 59-60, 292 N.W.2d 869, 871-72 (1980).

ARGUMENT

I. THE PRESUMPTION OF CORRECTNESS DOES NOT APPLY TO 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., 2009 WI App 46, ¶ 12. Both conditions apply here, and the City therefore is not entitled to a presumption of correctness of the assessments.

II. 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. This Court has reaffirmed that the WPAM controls, except to the extent it conflicts with governing law. Metro. Holding, 173 Wis. 2d at 632-33, 495 N.W.2d at 317.

Section 70.32(1) codifies this Court's holding in Markarian that the best evidence of fair market value typically is a recent sale of the subject property or, if there has been no recent sale of the subject, then sales of reasonable comparable properties. Markarian, 45 Wis. 2d at 686, 173 N.W.2d at 629. That does not mean that the comparable sales approach must, or may, always be used in valuing property, however. To the

contrary, while § 70.32(1) directs an assessor to "consider" the comparable sales approach in the absence of a recent sale of the subject property, 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. 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.) In that event, the assessor is to utilize other "professionally acceptable appraisal practices" such as the income or cost method. Wis. Stat. § 70.32(1). This general approach is known as the "Markarian hierarchy."

The WPAM specifically recognizes that the comparable sales approach generally is not a reliable method for assessing subsidized housing projects. The WPAM prohibits consideration of market rate properties as comparable sales in assessing subsidized housing, because the latter has different operational constraints and risk factors. (Ex. 34, p. 9-42.) Moreover, to be considered comparable, other subsidized housing projects must have "similar restrictions" as the subject property. (Id. at 9-45.) There are wide variations in the restrictions applicable to subsidized housing, and the agreements that set forth such restrictions are not readily available to assessors. Without actually examining the agreements for the

other properties, assessors cannot establish reasonable comparability of the restrictions. The WPAM recognizes the "limited availability of data" on the restrictions in particular subsidized housing agreements, which effectively negates the ability to rely upon the comparable sales approach. (Id.)

The WPAM identifies the cost approach as the "least reliable" for valuing subsidized housing due to difficulties in estimating economic obsolescence attributable to the applicable restrictions, and because construction costs tend to be higher than for market rate apartments. (Ex. 34, p. 9-43.) The cost approach is particularly inappropriate in valuing IRC § 42 properties because Wis. Stat. § 70.32(1g) specifically prohibits assessors from including the value of the federal tax credits in the assessment, and there is no reliable way to exclude the influence of the tax credits.

Accordingly, the WPAM specifies the income approach as the most reliable and therefore the "most useful" method for assessing subsidized housing. (Id.) Other valuation sources similarly, and unanimously, recognize that the comparable sales approach is not reliable in assessing subsidized housing and that the income approach is the only reliable method for valuing such developments. See, e.g., K. Alford and D. Wellsandt, "Appraising Low-Income Housing Tax Credit Real Estate," The Appraisal Journal pp. 352-53, 352 (Fall 2010) (Ex. 36):

> The extreme scarcity of comparable sales and the difficulties in evaluating the differences between the comparable properties' LURAs present formidable obstacles to performing a credible sales comparison approach for an LIHTC property.
>
> * * *
>
> Because of the steep challenges encountered in the cost approach and sales comparison approach, the income capitalization approach is generally considered the best indicator of an LIHTC property's value.

See also Ex. 54, pp. 2, 10, 13, 17; Ex. 55, p. 11; Ex. 56, p. 35.

In addition to identifying the income approach as the appropriate method for valuing subsidized housing, the WPAM also describes how to apply the income approach in assessing subsidized housing.

- The assessor must use the subject property's actual income and expenses, not market rates. (Ex. 34, p. 9-43.)
- The preferred method for determining the cap rate is the market derived method, i.e. determining a cap rate from recent market sales of ***similar properties***. (Ex. 33, p. 9-24.)

The Uniform Standards of Professional Appraisal Practice ("USPAP"), which apply to all appraisers including the assessors (Ex. 29, pp. 1-2 to 1-4), specify 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.)

III. THE HUD § 8 AND MARKET RATE PROPERTIES THE ASSESSORS USED FOR THEIR COMPARABLE SALES APPROACH ARE NOT "REASONABLY COMPARABLE" TO THE SUBJECT IRC § 42 PROPERTY.

While there are many bases on which to challenge the assessors' purported comparable sales valuation for 2013, for purposes of this appeal Regency West will focus on one glaring error: all three of the comparison sales upon which the assessors relied fail the basic test of comparability for subsidized housing because none has "similar restrictions" as the subject § 42 property.

One of the assessors' comparable sales – Lake Oakes – consists predominantly of market rate apartments, with only a small fraction of § 42 units. It is a clear violation of the WPAM and accepted appraisal practices to use a predominantly market rate apartment building as a comparable sale when valuing a § 42 project because the two types of property operate differently and in different markets. (Ex. 34, p. 9-42; McLaughlin, R.38, p. 145.)

The assessors' remaining two comparison properties – Woodside Village/Albert House, upon which they 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.) Even without considering the specific agreements applicable to these properties, which the assessors

did not bother to obtain and review, it is clear they also cannot satisfy the test of reasonable comparability because they operate under a federal program that has entirely different restrictions than the § 42 program applicable to the subject property. The WPAM and the undisputed testimony of Lerner and McLaughlin clearly establish that IRC § 42 and HUD § 8 are completely different programs that do not impose "similar restrictions." Regency West's § 42 property is subject to both rent restrictions and tenant income restrictions, receives no guaranteed rents, and has all the investment risks described above. In contrast, the two HUD § 8 properties do not have the same tenant income or rent restrictions (and are even allowed to charge above-market rents), receive substantial government rent subsidies, and do not have the same investment risks as § 42 properties. (Ex. 34, pp. 9-40, 9-42; Lerner, R.37, pp. 128-31, 161-63, 166-208; McLaughlin, R.39, pp. 79-84; Statement of Facts §§ 1a. and 1.b. supra.)

The City's witnesses did not purport to refute this evidence establishing the material differences in restrictions between IRC § 42 and HUD § 8 and the fact the two types of housing operate in different markets, nor could they since none of them has any experience with subsidized housing. Instead, they simply announced, contrary to the 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 upholding the assessors' comparable sales valuation, both the trial court and the court of appeals ignored the legal standards for reasonable comparability, ignored the WPAM's requirement of "similar restrictions," and simply deferred to the City's witnesses' bare assertion that the assessors' comparison properties were reasonably comparable. (R.31, p. 8, App. 8; Ct App. slip op. ¶ 15, App. 6.) Such deference cannot be justified under the rubric of an expert witness credibility determination, as the court of appeals suggested. (Slip op. ¶¶ 12, 15, App. 5, 6.) This Court has made it clear that the issue whether an assessment complies with the WPAM and Wisconsin law is a question of law. Adams Outdoor Advert., 2006 WI 104, ¶ 26. Following Adams, the court of appeals rejected the argument in Allright Properties that the question whether an expert complied with the income approach required in the WPAM was an issue of expert credibility determination, holding it was a question of law. Allright Props., 2009 WI App 46, ¶ 51.

The same conclusion follows here. The City's witnesses' uninformed and conclusory opinions about the propriety of the assessors' use and application of the comparable sales approach do not, and cannot, trump the contrary legal requirements applicable to the assessment of subsidized housing properties. See also Hicks v. N.Y. Fire Ins. Co., 266 Wis. 186, 189, 63 N.W.2d 59, 61 (1954) (reversing judgment where expert opinion was based on unwarranted assumptions).

The undisputed evidence clearly establishes that HUD § 8 properties are not reasonably comparable to IRC § 42 properties. The law is clear that properties that are not reasonably comparable may not be used in applying the comparable sales approach. Because the assessors impermissibly relied upon § 8 and market sales as comparisons for the comparable sales approach upon which they premised the 2013 assessment of the subject property, the 2013 assessment is invalid.

IV. THE ASSESSORS' INCOME METHODOLOGY VIOLATES WISCONSIN LAW.

The assessors' application of the income methodology for the 2012 and 2013 assessments violates Wisconsin law in two respects: (1) they used an estimated market expense ratio rather than the expenses specific to the subject property, and (2) they derived their cap rate from sales of market rate apartment buildings rather than from sales of other § 42 properties. The trial court and court of appeals erroneously excused both violations.

A. Improper Use of Market Expense Ratio

The trial court acknowledged the legal requirement of using the subject property's actual income and expenses rather than market rate income and expenses in assessing subsidized housing projects. (R.31, p. 8, App. 17, citing Metro. Holding, 173 Wis. 2d at 631.) It concluded the assessors' error was immaterial, however, because the assessments were

based on the comparable sales approach rather than the income approach. (Id., App. 17-18.) To the contrary, the 2012 assessment was based exclusively on the income approach, and the assessors acknowledged at trial that the validity of that assessment depends on the propriety of utilizing a market expense ratio. (Ex. 11; Anderson, R.37, p. 16; Scites, R.39, p. 49.) Moreover, the validity of the 2013 assessment, which the court of appeals similarly upheld on the ground the assessors' error was immaterial (slip op. ¶ 18, App. 7), also necessarily depends on the income approach since the assessors' comparable sales valuation was invalid for the reasons discussed above.

The court of appeals suggested it was reasonable for the assessors to rely upon a market expense ratio for the 2012 assessment because Regency West did not have a full year of actual operating expenses available as of the assessment date. (Slip op. ¶ 18, App. 7.) It cited no authority for any such exception to Metropolitan Holding. Regency West presented 2012 expense projections specific to the subject property from four different sources – including WHEDA – that were all consistent. In a retrospective appraisal, the appraiser considers the information that would have been available to a prospective buyer as of the valuation date. In the absence of prior year financial statements, a prospective buyer would consider the subject property's expense projections. (McLaughlin, R.38, p. 100; R.45, pp. 244-45.) The proxy for actual expense data therefore are projected

expenses for the subject property, not a market expense ratio that has nothing to do with the operating expenses for the subject § 42 property.

The reason for requiring the use of subject property specific 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, id. at 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.)

The danger of relying upon market expense ratios is aptly demonstrated in this case. The assessors used a 40% expense ratio in assessing the subject property, which translated to an assumption of

approximately $250,000 in operating expenses. (Ex. 11; Ex. 12, p. 16.) In fact, Regency West's projected expenses for 2012 as of the end of 2011 (used for McLaughlin's 2012 value) were $308,840, or 52% of its income, and its actual audited expenses for the year ending December 31, 2012 (used for McLaughlin's 2013 value) were $332,860, or 53.8% of its income. (Ex. 40, pp. 3, 4.) The assessors' understatement of Regency West's expenses by improperly relying on a market expense ratio alone resulted in inflating the subject property's assessments by over $1 million. (McLaughlin, R.38, pp. 123, 130, 160.)

Here, it is undisputed that the assessors used a market expense ratio rather than the expenses specific to the subject property in their income valuations for both 2012 and 2013. The law is clear that use of market rate expenses is improper in valuing subsidized housing. It follows that the 2012 and 2013 assessments are invalid. Metro. Holding, 173 Wis. 2d at 633-34, 495 N.W.2d at 317-18 (reversing assessment of subsidized housing project where assessor's income approach was based on estimated market rents and expenses).

B. Improper Reliance on Cap Rates Derived from Sales of Market Rate Apartment Buildings

The assessors purported to use the WPAM's preferred "market derived" method for determining their 6% base cap rate. (Anderson, R.37, pp. 33-34.) The WPAM describes that method as determining a cap rate

"from recent market sales of ***similar properties***." (Ex. 33, p. 9-24; emphasis added.) Unlike McLaughlin, 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 sales of § 42 properties. (Anderson, R.37, p. 37-39; R.39, p. 68; Scites, R.39, p. 47; McLaughlin, R.45, pp. 211-12.) After adding the property tax rate, the assessors used loaded cap rates of 8.5% for 2012 and 9.0% for 2013. (Ex. 11; Ex. 12, p. 16.)

The market for § 42 properties is completely different from the market for market rate apartment buildings. (Lerner, R.37, pp. 185-86; McLaughlin, R.38, pp. 82, 105; R.45, 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.) The WPAM expressly recognizes that "[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." (Ex. 34, p. 9-45.)

The trial court acknowledged that 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. (R.31, p. 9, App. 18.) Here, the assessors' market-rate-apartment-derived cap rate was way too low and greatly inflated their assessments. (McLaughlin, R.38, p. 140.)

The trial court nevertheless dismissed Regency West's cap rate challenge in one sentence, 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, App. 18.) The trial court thus misread 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 was whether the subsidized interest rate or a market mortgage interest rate should be used in determining the appropriate cap rate under the alternative "band of investment" method, not the market derived method at issue here. 2004 WI App 158, ¶ 7; 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; Ex. 33, p. 9-26.

The court of appeals recognized the trial court's erroneous reliance on Mineral Point Valley (slip op. n. 8, App. 8) yet similarly gave short shrift to Regency West's cap rate argument, reasoning that the source upon which the assessors relied included § 42 properties. (Id. ¶ 18, App. 7-8.) To the contrary, the assessors' cap rate source did ***not*** include sales of § 42

properties, but rather reported sales of market rate apartment buildings. (McLaughlin, R.45, pp. 211-12.)

The cap rate question in this case is which "market" to consider in deriving a market cap rate. The WPAM answers that question, directing assessors to determine the cap rate from recent market sales of "similar properties." (Ex. 33, p. 9-24.) The WPAM also makes clear that § 42 properties are not similar to market-rate apartment buildings. Rather, "they have specific operational restraints (regulations) and risk factors that are different from a market rate property" and therefore "should be considered as a separate market and distinct from conventional (market level) projects." (Ex. 34, p. 9-42; see also id. at p. 9-45.) The assessors' use of a 6% base cap rate, derived from sales of market rate apartment buildings rather than from sales of § 42 properties, was erroneous and improperly inflated the assessments.

The undisputed evidence from sales of ***similar*** properties, i.e. other § 42 properties, establishes market derived base cap rates of 8.0% for 2012 and 7.6% for 2013 and loaded cap rates of 10.54% and 10.44%, respectively (McLaughlin, R.38, p 136; Ex. 46.)[9] Application of these

[9] The court of appeals implied that since McLaughlin was able to obtain information on sales of § 42 properties to derive cap rates, he must have been able to apply the comparable sales approach. (Slip op. at 8, App. 8.) To the contrary, knowing the cap rate from a sale price does not provide the information on set-asides and other restrictions necessary to perform a reliable comparable sales analysis. (McLaughlin, R.38, pp. 106, 169-70.)

higher cap rates derived from the ***relevant*** market, together with correcting Regency West's expenses, results in actual market values of $2,700,000 and $2,730,000 rather than the City's assessed values of $4,425,000 and $4,169,000. (Ex. 40, pp. 3, 4; McLaughlin, R.38, pp. 137-29.)

V. REGENCY WEST'S EXPERT APPROPRIATELY RELIED SOLELY UPON THE INCOME APPROACH.

Regency West's expert, McLaughlin, explained that, while it may be 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 also did not use the cost approach because, as the WPAM recognizes, that approach necessarily and impermissibly includes the value of the tax credits in violation of Wis. Stat. § 70.32(1g) and is the least reliable. (Ex. 34, p. 9-45; McLaughlin, R.38, pp. 107-08.)[10] He therefore relied solely upon the income approach in appraising the subject property. (McLaughlin, R.37, pp. 76, 101-06, 08; R.45, pp. 212-14; Ex. 40, ¶¶ 4-5.)

The trial court criticized McLaughlin and rejected his opinions, concluding he "failed to follow the Markarian order" and violated Bischoff, 81 Wis. 2d 612, by relying solely upon the income approach. (R.31, pp.

[10] As noted above, the assessors concur that the cost approach is not reliable in assessing subsidized housing, and they did not rely upon that methodology in assessing the subject property. (Anderson, R.37, pp. 48-51; Scites, R.38, p. 251.)

10-11, App. 19-20.) The court of appeals' upheld the trial court's rejection of McLaughlin's opinions, deferring to the trial court's "drawing of inferences and weighing of expert witnesses' opinions." (Slip op. at 9, App. 9.)

The lower courts erred in disregarding McLaughlin's opinions just because he relied solely upon the income approach. As discussed above, the Markarian hierarchy codified in Wis. Stat. § 70.32(1) does not mandate reliance upon the comparable sales approach in all cases. An important prerequisite to the use of that approach is the availability of "reasonably comparable" sales. For the very reasons the WPAM and other authorities recognize the comparable sales approach is not a reliable approach in valuing subsidized housing properties, McLaughlin explained he could not reliably apply that approach, i.e. he did not have access to the LURA agreements for other recently sold § 42 properties to enable him to compare restrictions and determine whether they were reasonably comparable. Without such data, the WPAM makes clear the comparable sales approach may not be used. So McLaughlin did not "fail to follow" the Markarian hierarchy by not relying upon the comparable sales approach. To the contrary, he complied with that hierarchy by enforcing the condition of "reasonably comparable" sales.

Nor did McLaughlin violate Bischoff. That case does not stand for the broad proposition that an assessment never may be premised on a single

valuation methodology, as the trial court suggested. Bischoff has nothing to do with the unique challenges in valuing subsidized housing, but rather 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 data available to establish reasonably comparable sales.

McLaughlin's conclusion that the income approach is the only reliable approach to use in valuing the subject § 42 property complies with the WPAM and is entirely correct. While the WPAM suggests generally that 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. (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*** . . . .

(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.

In Adams Outdoor Advertising, 2006 WI 104, ¶ 53 (emphasis added), this Court also approved of reliance on a single valuation method in certain situations:

> 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 most reliable.

Adams thus 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.

Sole reliance on the income approach for subsidized housing valuations repeatedly has been upheld by Wisconsin appellate courts. Metro. Holding, 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 lower courts ignored these legal authorities when they concluded McLaughlin's sole reliance on the income approach violated Wisconsin law. When the comparable sales and cost approaches are 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. The lower courts therefore erred in rejecting McLaughlin's competent opinions and

ruling Regency West failed to overcome the presumption of correctness just because McLaughlin relied solely on the income approach. Steenberg v. Town of Oakfield, 167 Wis. 2d 566, 572, 482 N.W.2d 326, 328 (1992) (reversing court of appeals decision upholding assessment where property owner overcame presumption of correctness).

Indeed, McLaughlin is the only witness who complied with Wisconsin law in his valuations of the subject property. He used the correct methodology – the income approach. He correctly applied that methodology by using income and expenses specific to the subject property, and by deriving his cap rate from sales of similar properties, i.e. § 42 properties. His report and testimony not only constitute "significant contrary evidence" to overcome the presumption of correctness of the assessments, but satisfy Regency West's burden of persuasion. Regency West therefore is entitled to judgment in its favor for refunds based on the difference between the assessments and the values as determined by McLaughlin.

CONCLUSION

The lower courts' decisions are premised upon erroneous legal conclusions regarding both the validity of the assessors' methodologies used for the 2012 and 2013 assessments and the propriety of McLaughlin's valuations. When those errors are corrected, it is readily apparent that the assessments are contrary to the WPAM and other Wisconsin law, and that

Regency West presented significant contrary evidence establishing that the assessments are excessive. The presumption of correctness therefore does not apply. Bonstores Realty One, 2013 WI App 131, ¶ 5; Allright Props., 2009 WI App 46, ¶ 12. Moreover, McLaughlin's income valuations are "by the book" and establish the correct values of the subject property as of the assessment dates.

For all of the foregoing reasons, Regency West respectfully requests that this Court reverse the court of appeals' decision, determine that the 2012 and 2013 assessments should be $2,700,000 and $2,730,000, respectively, and direct the entry of judgment in Regency West's favor accordingly.

Dated this 27th day of January, 2016.

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 9,466 words.

Dated this 27th day of January, 2016.

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APPENDIX CERTIFICATION

I hereby certify that filed with this brief, either as a separate document or as part of this brief, is an appendix that complies with § 809.19(2) and that contains, at a minimum: (1) a table of contents; (2) the court of appeals decision; (3) the judgments, orders, findings of fact, conclusions of law and memorandum decisions of the circuit court; (4) portions of the record essential to an understanding of the issues raised, and (5) any unpublished opinion cited in the brief.

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.

Dated this 27th day of January, 2016.

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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 Petitioner's Brief are identical to the text of the paper copies.

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CERTIFICATE OF MAILING

I certify that Petitioner's Brief and Appendix were deposited in the United States mail for delivery to the Clerk of the Supreme Court by first-class or priority mail, or other class of mail that is at least as expeditious, on January 27, 2016. I further certify that the Brief and Appendix were correctly addressed and postage was pre-paid.

Dated this 27th day of January, 2016.

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