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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
Circuit Court Nos. 13-CV-1546 and 13-CV-1848

PETITIONER'S REPLY BRIEF

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INTRODUCTION

The City's response brief largely ignores Regency West's arguments. Recognizing it cannot defend the assessments under controlling legal standards, the City insists this Court should sustain the assessments because its outside appraisers, Furdek and Weissenfluh, blessed them.

Regardless of how many years Furdek and Weissenfluh have been general assessors, the fact remains they have no experience with subsidized housing whatsoever. Their appraisal blatantly violates the WPAM and Wisconsin law in the same respects as the assessments and should be disregarded.

ARGUMENT

I. DE NOVO REVIEW APPLIES.

The City does not dispute that the propriety of an assessor's methodology and compliance with statutory requirements are legal issues subject to de novo review, not issues of witness credibility entitled to deference. (Pet. Br. 23, 30-31.) The trial court found the City's witnesses more "credible" only because of its legal errors. Those legal errors are not entitled to deference as "factual findings." (Resp. Br. 2, 26.)

II. AS A MATTER OF LAW, § 8 AND MARKET RATE APARTMENTS ARE NOT "REASONABLY COMPARABLE" TO A § 42 PROPERTY.

The City does not dispute that the Woodside Village/Albert House and McMynn Tower properties the assessors used in their 2013 comparable

sales analysis consist exclusively of § 8 rent subsidized units, and the Lake Oakes property consists predominantly of market rate apartment units. (Pet. Br. 17-19.) Nor does the City dispute that there are substantial and material differences between § 42 and § 8 properties, and between § 42 and market rate properties. (Id. at 10-14, 25, 28-29.)

The City similarly does not refute the controlling authorities discussed in Regency West's opening brief establishing that special rules apply to the assessment of subsidized housing properties, and that it is not appropriate to utilize the comparable sales approach in assessing such properties because it is not reliable. (Pet. Br. 24-27, 38-42.) It cites three arguments in defense of the assessors' comparable sales approach, none of which has any merit.

First, the City points out the WPAM covers all types of subsidized housing in the same section. (Resp. Br. 21.) That does not mean all types of subsidized housing are interchangeable. The WPAM carefully distinguishes among 10 different types of subsidized housing programs; instructs assessors to determine the terms and conditions of the "particular program" by obtaining the regulatory agreement; and requires that to be considered comparable, "the recent arm's-length sales should have ***restrictions that are similar to the subject property***." (Ex. 45, pp. 9-38 to 9-42, 9-45; emphasis added.) There would be no reason to go to the trouble of distinguishing among the different programs if they were

interchangeable. It is undisputed that § 42 restrictions are not similar to § 8 restrictions; it is undisputed that the WPAM requires similar restrictions; and it follows that the WPAM prohibits consideration of § 8 properties in valuing a § 42 property.

Second, the City argues the "rents for the [§ 8 and § 42] properties were essentially the same." (Resp. Br. 23.) The undisputed evidence proves otherwise. Lerner testified that § 42 properties rent for $100-$250/mo below market rates, whereas § 8 properties rent at or above market rates. (R.37, pp. 186-87; R.38, p. 8.)[1] The City's work papers confirm that a 3-bedroom apartment at the Woodside Village/Albert House § 8 property rents for $942/month, whereas a 3-bedroom apartment at the subject § 42 property rents for only $773/month. (Ex. 61, p. 2.) In any event, what the WPAM requires is similar ***restrictions***, not similar rents. (Ex. 34, p. 9-45.) Rent similarity only affects revenues and does not account for the greater operational and investment risks with § 42 projects that materially increase actual expenses and decrease market values. (Pet. Br. 10-13.)

Third, the City argues that even if the assessors' comparable sales methodology was flawed, the assessments should be upheld because they are supported by the Furdek/Weissenfluh appraisal. (Resp. Br. 22-23, 36-

[1] Lerner did not "concede" § 42 and § 8 rents are the same, as the City represents. (Resp. Br. 23.) The subject property has no § 8 units, all are § 42. In the testimony referenced by the City, Lerner testified that if a tenant has a § 8 portable voucher – which is completely different than the § 8 rent subsidy program at issue here – that tenant would pay the same rent as all the other tenants. (R.38, pp. 7-8.)

38.) To the contrary, the Furdek/Weissenfluh appraisal suffers from the same flaws as the assessors'. Furdek and Weissenfluh did not use other § 42 properties as their comparisons, as the City represents. (Id. at 13.) Their Bradley comparison consisted of § 8 and market rate units and had no § 42 units at all. (Ex. 68, p. 2; Ex. 69; Lerner, R.45, pp. 174-75.)[2] Their Lake Oakes comparison, the same comparison used by the assessors, consisted of predominantly market rate apartments. The apartments in their City Hall Square comparison similarly were predominantly market rate, and that property also had a substantial amount of commercial space. (R.45, pp. 177-78; Ex. 70.)[3] So like the assessors, Furdek and Weissenfluh impermissibly used as comparisons properties that do not have similar restrictions as the subject property and do not meet the basic test of reasonable comparability, in direct violation of the WPAM. Their appraisal therefore not only fails to redeem the assessments, but should be disregarded.

[2] Before being confronted with their error in assuming Bradley was a § 42 property, Weissenfluh testified at deposition it would be improper to use a § 8 property as a comparison in valuing a § 42 property. (R.45, pp. 149-52.) In an effort to rehabilitate this crucial error in their assumptions, Furdek insisted at trial – directly contrary to the WPAM – that differences in restrictions do not matter. (R.44, pp. 37-38.)

[3] Far from "hitting a bull's eye" and constituting "powerful evidence of their skill" (Resp. Br. 38), Furdek's and Weissenfluh's reliance on the City Square property as a comparison without even recognizing its apartments were predominantly market rate rather than § 42 evinces their failure to comply with the WPAM's most basic sales verification requirements. (Ex. 31, p. 9-10.)

III. THE ASSESSORS' APPLICATION OF THE INCOME APPROACH VIOLATED THE WPAM.

A. Reliance on Market Expense Ratio Rather than Actual Expenses

The law is clear that in assessing subsidized housing, the assessor must use the subject property's actual income and expenses, not market rates. Metro. Holding Co. v. Bd. of Review of Milwaukee, 173 Wis. 2d 626, 634, 495 N.W.2d 314, 318 (1993); WPAM, Ex. 34, p. 9-43. The City argues Metropolitan Holding was "limited" by Bloomer Hous. Ltd. Partnership v. City of Bloomer, 2002 WI App 252, 257 Wis. 2d 883, 653 N.W.2d 309 and Mineral Point Valley Ltd. Partnership v. City of Mineral Point Board of Review, 2004 WI App 158, 275 Wis. 2d 784, 686 N.W.2d 697. (Resp. Br. 18.) Bloomer and Mineral Point are cap rate cases, not actual expense cases. (Pet. Br. 36-37.) They do not purport to excuse an assessor's reliance on market rate expenses rather than actual expenses in assessing subsidized housing.

It is undisputed that for both the 2012 and 2013 assessments, the assessors used a market expense ratio of 40% rather than relying upon the expenses specific to the subject property. (R.11; R.37, pp. 25, 27-28, 30; R.39, p. 5; see also Resp. Br. 7-8, 17-18, 19.) The City attempts to defend reliance upon a market expense ratio on the basis the subject property did not have actual operating history as of the time of the 2012 assessment. (Id. 17-18.) As explained in Regency West's opening brief, the proxy for actual

expenses as of January 1, 2012 were the subject property's 2012 projections available as of the valuation date, not a market expense ratio. (Pet. Br. 21, 32-33.) The City does not dispute that those projections were reliable. Nor does it attempt to justify the assessors' continued reliance on their 40% estimated market expense ratio for the 2013 assessment notwithstanding they possessed Regency West's December 31, 2012 audited financials establishing much higher actual expenses. (R.37, pp. 45-46, 52-54.)

The City again relies on the Furdek/Weissenfluh appraisal to justify the excessive values determined under the assessors' income approach. (Resp. Br. 9-11.) Such reliance again is misplaced. Among other errors, while Furdek and Weissenfluh purported to consider the actual expenses for the subject property in their income approach, they reviewed the expenses for the wrong years.

A retrospective appraisal requires an assessor to consider the information available to a buyer as of the relevant assessment date, which in this case was January 1, 2012 and January 1, 2013. This requirement is confirmed by USPAP Stmt-3, p. U-85: "the effective date should be used as the cut-off date for data considered by the appraiser." (Supp. App. 4; see also FAQs 141 and 144, Supp. App. 5, 6.) Consistent with USPAP, McLaughlin used the subject property's projected 2012 expenses as of late 2011 for his 2012 appraisal, and he used the expenses set forth in the

audited December 31, 2012 financial statements for the 2013 appraisal. (Pet. Br. 21.)

In contrast, Furdek and Weissenfluh considered the subject property's December 31, 2012 financials for their January 1, 2012 appraisal and considered its December 31, 2013 financials for their January 1, 2013 appraisal. (Furdek, R.40, pp. 22-23.) This approach not only violates USPAP, incorporated in the WPAM (Ex. 29, pp. 1-2 to 1-4), but defies common sense. A purchaser on January 1 of a given year obviously would not know as of that date what a property's actual year-end expenses for that year would be.

The City cites Rosen v. City of Milwaukee, 72 Wis. 2d 653, 242 N.W.2d 681 (1976) as permitting reliance upon post-valuation date financial information. (Resp. Br., pp. 18, 33.) Rosen did not involve the income approach, but rather the comparable sales approach. The court concluded that so long as the sale was close in time to the valuation date and the market had not changed in the interim, it could be considered. Id. at 666, 242 N.W.2d at 686. Unlike sales, subsequent year financial data is not evidence of a "market trend." Neither USPAP nor Rosen permits consideration of post-valuation date financial performance in the income approach.

In addition to their error in considering post-assessment date financial information, under the guise of "stabilizing" expenses Furdek and

Weissenfluh arbitrarily substituted their view of "reasonable" expense percentages and vacancy rates for the subject property's actual expenses and vacancy rates, a clear violation of Metropolitan Holding. (Ex. 119, pp. 49, 50; Furdek, R. 45, pp. 97-98, 103, 104; McLaughlin, id. at 246-47, 259-60.) The City cites ABKA Ltd. P'ship v. Bd. of Review of Fontana-On-Geneva-Lake, 224 Wis. 2d 551, 591 N.W.2d 879 (Ct. App. 1999) as supporting the use of market expense ratios to "stabilize" expenses. (Resp. Br. 8, 19, 33.) ABKA has nothing to do with subsidized housing, so the requirement of using the subject's actual expenses did not apply. Moreover, in ABKA the assessor relied upon the subject's income and expenses for ***pre-valuation*** years, not post-valuation, in constructing a stabilized operating statement. 224 Wis. 2d at 564, 591 N.W.2d at 885. Nothing in ABKA supports either the assessments or the Furdek/Weissenfluh appraisal.

The assessors plainly violated Metropolitan Holding in relying upon a market expense ratio rather than the expenses specific to the subject property. That legal error alone invalidates the 2012 and 2013 assessments.

B. Reliance on the Wrong Cap Rate "Market"

The WPAM requires cap rates to be derived from "recent market sales of ***similar properties***." (Pet. Br. 34-35.) The City persists in misreading this requirement as mandating use of a cap rate derived from sales of market rate properties, citing Bloomer and Mineral Point. (Resp.

Br. 19-20.) Regency West distinguished Bloomer and Mineral Point in its opening brief. Those cases have nothing to do with determining a ***market derived cap rate*** from ***similar properties***, but rather address the proper interest rate to be considered when applying the alternative band of investment cap rate method. (Pet. Br. 36-37.) The City fails to address this distinction, which the court of appeals recognized in observing that the trial court erred in criticizing McLaughlin's cap rate analysis based on Mineral Point. (Slip op. n.8, App. 8.)

The City admits the assessors used a cap rate derived from sales of market rate apartment buildings, not sales of properties similar to the subject property. (Resp. Br. 7, 8, 18, 19.) So did Furdek and Weissenfluh. (Ex. 119, pp. 53-55, 58; Furdek, R.40, pp. 78-79.) The WPAM specifies that market rate apartments are not similar to subsidized housing. (Ex. 33, p. 9-24; Ex. 34, p. 9-45.) The 2012 and 2013 assessments, as well as the Furdek/Weissenfluh appraisal, thus clearly violated WPAM with respect to the cap rate.

IV. THE CITY'S CRITICISMS OF MCLAUGHLIN ARE UNFOUNDED; HIS ANALYSES PROVE THE ASSESSMENTS ARE EXCESSIVE.

The City's efforts to discredit McLaughlin's report and testimony are specious. McLaughlin is a well-respected appraiser who, unlike the City's witnesses, has appraised literally hundreds of subsidized housing projects over the past 25 years. His sole reliance on the income approach is

supported by the WPAM and other authorities discussed in Regency West's opening brief. (Pet. Br. 36-40.) Those authorities are not, as the City argues, limited to cases where the parties both agreed to rely upon the income approach. (Resp. Br. 31). Rather, they unequivocally and uniformly support reliance on a single valuation method where, as here, there is only one reliable method.

The fact McLaughlin assembled information on sale prices of § 42 properties for purposes of deriving cap rates does not mean those sales support a comparable sales valuation, as the City "presumes." (Resp. Br. 10, 24, 29.). McLaughlin explained he did not have information on the restrictions applicable to those properties, which the WPAM requires as a condition for using them in a comparable sales analysis. (R.38, pp. 106, 169.)

The City's suggestion McLaughlin "failed to stabilize expenses" (Resp. Br. 33) is a reference to his reliance on pre-valuation rather than post-valuation financial data, which was entirely appropriate for his retrospective appraisals. His familiarity with the cap rate for sales of market rate apartment buildings in Racine (id. at 12) is irrelevant since the WPAM requires consideration of cap rates for sales of "similar" properties, and market rate apartments are not similar to § 42 properties.

The City's representation that McLaughlin used lower cap rates in his appraisals of other subsidized housing is disingenuous. (Id.) As the

City is well aware, those appraisals were not prepared for property tax purposes, so the cap rates were not loaded with the property tax rate. (R.38, p. 168.) Adding the 2.5% tax rate, the loaded cap rates for the other properties would have been 11.7% and 12.4%, even higher than the cap rates McLaughlin used for his appraisals of the subject property.

The City's suggestion that the Furdek/Weissenfluh cost approach supports the assessments, and its criticism of McLaughlin for not relying on that approach (Resp. Br. 39-40), ignore that the WPAM identifies the cost approach as the least reliable. (Ex. 34, p. 9-45.)[4] Even the assessors recognized the cost approach as unreliable and did not use it for the assessments. (R.37, pp. 48-51.) The Furdek/Weissenfluh cost approach inflated the assessable value of the subject property by failing to make any adjustments for economic obsolescence to take into account the restrictions, as the WPAM recognizes would be required but virtually impossible to determine reliably. (Ex. 34, p. 9-45; R.45, pp. 91, 160-61.)

Finally, the fact McLaughlin's report is only four pages long and does not meet all the technical USPAP requirements is immaterial. (Resp. Br. 34-36.) This is a classic case of the pot calling the kettle black. USPAP requirements apply not only to appraisers such as McLaughlin, but also to assessors. (Ex. 29, pp. 1-1, 1-3 to 1-4.) The assessors' 2012

[4] McLaughlin did not "concede" the propriety of the cost approach (Resp. Br. 39), but rather testified it is never appropriate to use the cost approach in assessing § 42 properties because the value of the tax credits must be excluded. (R.38, pp. 107, 222-23.)

valuation consists of one page comparable in format to the one-page valuations included in McLaughlin's report. (Compare Ex. 11 with Ex. 40.) Their 2013 report is longer only because it includes the impermissible comparable sales approach. (Ex. 12.) Neither of the assessors' reports includes the boilerplate sections the City criticizes McLaughlin for omitting. (Weissenfluh, R.45, pp. 146-47.) In any event, USPAP compliance is not a condition for admitting or relying upon an expert's report. 260 North 12th St., LLC v. State Dep't of Transp., 2011 WI 103, ¶¶ 54-55, 338 Wis. 2d 34, 808 N.W.2d 372.

CONCLUSION

Regency West's emphasis on the assessors' lack of subsidized housing expertise does not mean municipalities must hire outside specialists to assess such properties, as the City suggests. (Resp. Br. 27, 42.) Assessors can assess subsidized housing properly by simply complying with the WPAM: (1) use the income approach and not the comparable sales approach, (2) use the subject property's actual income and expenses, and (3) derive the cap rate from sales of other similarly restricted properties. The assessors failed to comply with these requirements in assessing the subject property, as a result of which the assessments violate the WPAM, are contrary to Wisconsin law, and are not entitled to a presumption of correctness.

In contrast, the report and testimony of Regency West's highly qualified subsidized housing expert, Scott McLaughlin, fully comply with the WPAM and Wisconsin law and establish the correct values of the subject property were $2,700,000 for 2012 and $2,730,000 for 2013. (Ex. 40.) McLaughlin's valuations and testimony prove the assessments were excessive.

For all of the foregoing reasons, Regency West respectfully requests that the Court reverse the trial court's judgment; reduce the 2012 and 2013 assessments to $2,700,000 and $2,730,000, respectively; and order judgment for Regency West for refunds totaling $90,976.52, plus statutory interest and costs. (Ex. 1; Supp. App. 1.)

Dated this 18th day of February, 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 2,997 words.

Dated this 18th day of February, 2016.

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APPENDIX CERTIFICATION

I hereby certify that filed with this Reply Brief, either as a separate document or as a part of this brief, is a supplemental appendix that complies with sec. 809.19(2)(a), as applicable.

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

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CERTIFICATE OF MAILING

I certify that Appellant's Reply Brief and Supplemental Appendix was sent via Federal Express on February 18, 2016 for delivery to the Clerk of the Supreme Court. I further certify that the Reply Brief was correctly addressed and postage was pre-paid.

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