

**BEFORE THE BOARD OF TAX APPEALS
STATE OF KANSAS**

IN THE MATTER OF THE
EQUALIZATION APPEALS OF CITY OF
COUNCIL GROVE FOR THE YEAR 2014
IN MORRIS COUNTY, KANSAS

Docket Nos. 2014-2157-EQ
through 2014-2160-EQ

IN THE MATTER OF THE PROTESTS OF
CITY OF COUNCIL GROVE FOR THE
YEAR 2015 IN MORRIS COUNTY,
KANSAS

Docket Nos. 2016-406 PR
through 2016-409-PR

IN THE MATTER OF THE PROTESTS OF
CITY OF COUNCIL GROVE FOR THE
YEAR 2016 IN MORRIS COUNTY,
KANSAS

Docket Nos. 2017-876-PR
through 2017-879-PR

Court of Appeals
Docket № 121,005

ORDER ON REMAND

Now the above-captioned matters come on for consideration and decision by the Board of Tax Appeals of the State of Kansas. The Board conducted a hearing in these matters on May 3, 2018. The matters were fully submitted on October 25, 2018. A summary decision was issued on November 8, 2018, and a full and complete opinion was issued on February 1, 2019. These matters were then appealed to the Kansas Court of Appeals, which remanded these matters back to the Board of Tax Appeals in a Memorandum Opinion dated June 19, 2020. 465 P.3d 202 (Table) (“Memorandum Opinion”). The Board conducted a hearing on remand on May 18, 2021. At the hearing on remand, the Taxpayer, the City of Council Grove, appeared by Linda Terrill, Attorney. The County of Morris appeared by Michael Montoya, Attorney and Timothy Keller, MAI, Appraiser. No additional exhibits were admitted into evidence. The parties’ briefs on remand were filed on November 16, 2021.

The relevant factual and procedural background of this case and the unique nature of the subject property are recited in detail in the Memorandum Opinion. The Board will not repeat those discussions in their entirety, but for purposes of this Opinion on Remand notes that the subject property, Council Grove Lake, is owned by the City of Council Grove. The various parcels of land surrounding the lake are subdivided into individual lots, which the City then leases to individuals under 30-year lease terms, with automatic 30-year renewals. The rental rate of the leases ranged from \$1,000 per year in 2012 to \$1,200 per year in 2014. Testimony from various witnesses established that the \$1,000 to \$1,200 lease rates for the lake lots were not based upon a market rental rate, but rather were the result of a compromise decision motivated by a number of different factors.

In its original opinion, the Board's determination of value was based largely upon the income approach prepared by the County's expert witness, Tim Keller. Rather than use the stated rental rates of \$1,000 to \$1,200 per lot for each applicable tax year, Keller's income approach was premised on a rental rate for each lot of \$5,500 per year. Keller opined that this amount represented the lease rate for a similarly situated lake lot in an open and competitive market. Taxpayer's expert, Tom Slack, did not perform an independent appraisal of the property, but reviewed Keller's appraisal and concluded that Keller should have used the stated rental rate for each lot to arrive at a valuation for the subject property. After consideration of the testimony and evidence provided, the Board concluded that Keller's annual rental rate should be modified to the amounts of \$4,150, \$4,400, and \$4,500 for tax years 2014, 2015, and 2016. The Board adopted Keller's remaining income approach inputs as reasonable and supported by substantial competent evidence. Combination of the Board's modified annual rental rate with Keller's figures for expense reimbursements, a one percent vacancy and collection loss allowance, expense rates between 37 and 39 percent, and a capitalization rate of seven percent, yielded values of \$16,580,614 for 2014, \$17,579,400 for 2015, and \$17,657,143 for 2016.

The Court of Appeals remanded this matter to the Board to address the failure of the County's expert to adequately consider the actual lease rates in his opinion of value, and for explanation of what weight the subject property's stated rental rate was given in the Board's determination of value for the subject. *See* Memorandum Opinion, p. 14 ("The case is reversed and remanded so that the rent—as set by the lease—is used, "in connection with cost, income and other factors" to determine the fair market value of the property.") (citing K.S.A. 79-503a)). The Court of Appeals' ruling states that under K.S.A. 79-503a, Keller was required to "consider" the actual rent of the subject property when arriving at an opinion of value. *See id.* at p. 13-14 ("the governing statutes require that the actual rents be considered in arriving at the fair market value of real property.").

In its original opinion, the Board noted that when the City of Council Grove set the lease rate on the lake lots, no market studies were done to determine a fair market rent for the subject property. The lease rate reflected a compromise decision based upon a number of different factors, including a desire by lot lessees to keep property taxes at a stable level. The Board concluded, consistent with Keller's expert opinion, that the actual lease rate of the lake lots was not representative of an open market rate and should not be used to determine the fair market values of the subject properties.

One issue before the Board on remand, then, is what weight, if any, should be given to the below-market lease rate for the lake lots to determine overall value of the subject property, and whether the actual lease rate should control in the face of other competent evidence of market value. It should be noted that there is no actual dispute here that the lake lease rates are below-market. The Board will first review how Keller arrived at the market rent used in his income approach.

To determine what he believed was a market rental rate, Keller considered information from several sources, including two lake developments at Harlan County Lake in Nebraska, a development at Summer Haven Lake in Nebraska, vacant land sales at Lake Kahola and Lake Wabaunsee in Kansas, and improved lot sales at Council Grove Lake. Keller's review of those sources led him to conclude that lease rates of \$5,500 to \$5,800 per year for each of the three tax years at issue were appropriate "market" values. At the same time, however, Keller cited a study of lease lot rates showing that a typical lease rate was five percent of a property's fair market value. Keller determined that each Council Grove Lake lot's fair market value was \$83,000 per lot in 2014, \$88,000 per lot in 2015, and \$107,000 per lot in 2016. The Board found Keller's conclusions of the lots' fair market values to be reasonable and supported by substantial competent evidence in the record, including recorded, fee-simple sales of similar lake lots. Application of the five percent ratio of lease rate to fair market value to Keller's per-lot values for each Council Grove Lake lot would have resulted in annual rental rates for each lot from \$4,150 to \$4,500 for each of the three tax years.

The Board determined that rental rates in the range of \$4,150 to \$4,500 derived from each lot's fair market value were more reliable indicators of the open market rental rate for each lake lot, because the relationship of lot value to rental rate was a constant ratio that naturally reflected each lot's unique characteristics. For example, a lot with a higher market value due to desirable location, larger size, or better amenities would naturally result in a higher rental rate, using five percent of market value, than the rental rate for a lot of lesser value due to small size, undesirable location, or lack of amenities. The Board concluded that the process Keller used to find higher rental rates in effect double-valued factors like lot size and amenities rather than relying upon the market standard ratio of lot value to rental rate. The Board consequently determined that the best indicator of the subject property's fair market value in the record before it was an income approach utilizing Keller's parameters with the Board's modified rental rates.

K.S.A. 79-503 requires the Board to ensure that "the appraisal process utilized in the valuation of all real and tangible personal property for ad valorem tax purposes shall conform to generally accepted appraisal practices and standards which are consistent with the definition of fair market value unless otherwise specified by law." K.S.A. 79-505 gives further guidance as to the meaning of "generally accepted appraisal practices and standards" by requiring the Director of Property Valuation to adopt directives and standards governing the performance of appraisals for ad valorem tax purposes, including at a minimum, "[t]hat all appraisals be performed in compliance with the uniform standards of professional appraisal practice, commonly referred to as 'USPAP.'" K.S.A. 79-505(a)(1).

The Appraisal of Real Estate, 15th Edition (“ARE”) defines the term “market rent” as “[t]he most probable rent that a property should bring in a competitive and open market under all conditions requisite to a fair lease transaction” *Id.* at 420. It indicates that “[r]ent for vacant or owner-occupied space is usually estimated at market rent levels and distinguished from contract rent in the income analysis. In *fee simple valuations*, all rentable space is estimated at market rent levels and market terms.... Any rent attributed to specific leases is disregarded in the income analysis *except to the extent that these leases may be indicative of market rent.*” *Id.* (emphasis added). In contrast, the ARE explains that “[i]n a *leased fee* analysis, current contract rents defined by any existing leases are applied to leased space, structures, or land....” *Id.* (emphasis added). BOTA is required by Kansas law to make all valuation determinations based upon the market value of the property’s fee simple ownership interest. K.S.A. 74-2433(g); *see also In re Equalization Appeals of Walmart Stores, Inc.*, No. 122,162, p. 20 (Kan. July 1, 2022). In this instance, an appraisal that considered only current contract rents defined by the existing lake lot leases would have constituted a leased fee appraisal that is not permitted by Kansas law for valuation in the context of ad valorem taxation.

It is clear from Keller’s testimony both at the original hearing and at the hearing after remand that he concluded the contract least rates on each Council Grove Lake lot were below market. The Board finds no basis in the record to disagree with Keller’s conclusion on this point, particularly in light of specific testimony from individuals directly involved with the process that the contract rates were negotiated not to reflect the market for similar lease lots, but to achieve rent stability, prevent the city from raising rental rates on the lots, and keep the real estate taxes on the lots low. *See County Brief on Remand*, p. 11-13. Keller’s testimony establishes that he was clearly aware of the perpetual lease contracts in place on all of the Council Grove Lake lots but disregarded the actual contract rate in his analysis, because he did not find it to be indicative of the market rate that he was required to apply utilizing generally accepted appraisal principles. Keller’s approach here was, on its face, consistent with both the Appraisal Institute’s directive that an appraiser conducting an income approach analysis to determine a property’s fee simple value should use market rental rates, rather than contract rental rates, and with Kansas law requiring valuation of a fee simple estate, rather than a leased fee. *See ARE*, at 420; K.S.A 74-2433(g).

Tension exists between the ARE’s directive on market rents and the requirements in K.S.A. 79-503a(f), (g), and (h), which direct an appraiser to use sales “in connection with income and other factors including”

(f) productivity taking into account all restrictions imposed by the state or federal government or local government bodies, including but not limited to, restrictions on property rented to leased to low income individuals and families authorized by section 42 of the federal internal revenue code of 1986, as amended;

(g) earning capacity as indicated by lease price, by capitalization of net income or by absorption or sell-out period; and

(h) rental or reasonable rental values or rental values restricted by the state or federal government or local government bodies, including, but not limited to, restrictions on property rented or leased to low income individuals and families as authorized by section 42 of the federal internal revenue code of 1986, as amended.

The Court of Appeals here found that the perpetual ground lease on the Council Grove Lake lots “impacts productivity, sets rent, and imposes restrictions and requirements upon the use of the property. Under a plain language interpretation of K.S.A. 79-503a, Keller should have considered the lease when determining the fair market value of the Lake.” Opinion on Remand, p. 12 (citing K.S.A. 79-503a). The Court then observed “[w]hile there is extensive evidence about the assumptions used by the appraiser and the calculations made to determine a value, this case must be decided on the appraiser’s threshold refusal to consider the established rental values for the lake property. Not considering the rents as set by the lease does not conform to the statutory requirement to determine fair market value.” *Id.* at 13.

The second issue presented to the Board on remand, then, is what actions on Keller’s part constitute sufficient “consideration” of the rents set by the ground lease such that Keller’s ultimate value conclusions collectively assume a fee simple estate, comport with generally accepted appraisal principles, and satisfy the requirements of K.S.A 79-503a that he use sales “in connection with” other factors including governmental restrictions on productivity to determine a fee simple fair market value. Could Keller acknowledge the existence of the ground leases and their rental rates, determine those rates were not equivalent to the market rental value of the lots at issue, and use his appraisal judgment to determine that a market rental rate was more indicative of the property’s overall fair market value? The Court of Appeals gives little guidance on this point, other than to observe that it was “totally inconsistent for the appraiser to determine a valuation That does not take the lake rentals into account when that issue has previously been decided in the prior case involving the same parties.” *Id.* at 13 (noting the Court’s holding in a prior case that it was error for an appraiser not to consider the ground lease rates). The issue, as it has been framed by the taxpayer and the Court of Appeals, certainly seems to be an all-or-nothing proposition: either Keller adequately “considered” the contract lease rates, therefore applying only those rates to determine his value of the property, or he did not adequately “consider” the contract lease rates because he chose to apply a higher rate in his valuation of the property.

Perhaps there was another alternative available, wherein an appraiser would have used some other methodology to reconcile the contractual lease rate imposed by the City with a rental rate indicative of an open market. That, however, was not the case presented to the Board. The Board is bound to determine each case solely on the facts and evidence presented to it, and because Kansas law requires each property to be valued as of January 1 every year, each year presents a new and wholly independent case or controversy. Consequently, the Board’s conclusions as to this property in prior tax years are not binding or instructive for its current valuation, which is premised entirely upon different evidence and testimony. For the tax years at issue in this matter, Keller presented a USPAP-compliant appraisal that utilized the income approach with a market-derived rent to determine a value for property in fee simple. The Board

determined that adjustments were necessary to Keller's rental rate to avoid overvaluing certain lot characteristics, but otherwise found Keller's appraisal to be supported by substantial competent evidence. The taxpayer, in contrast, chose not to present any independent appraisal. Instead, the Taxpayer relied upon a review appraisal that criticized Keller's value conclusions and suggested a value premised solely upon the contractual rental rate, which is more akin to a leased-fee valuation. Taxpayer's review appraisal did not present any analysis of the relationship between the contract lease rates and the property's fair market value. Instead, Taxpayer's argument seems to be premised upon the conclusion that if a governmental entity sets a below-market lease rate on property, only that below-market lease rate can be used to determine the property's value for ad valorem tax purposes.

The Board notes that this is an unusual case in terms of the nature and structure of the lease agreements on the lots around Council Grove Lake. The Court of Appeals concluded that these ground leases are akin to governmental restrictions on productivity or rental rate such that K.S.A. 79-503a(f) and (h) mandate their consideration in the property's appraisal. But the Board notes that those two provisions of K.S.A. 79-503a specifically reference restrictions placed upon property that qualifies for low-income housing under section 42. Those restrictions notably have the effect of *decreasing* a property's market value, which is then offset by tax credits or other means to entice developers to pursue this type of property development. The relationship between the incentives to build low-income housing and the restrictions associated with receipt of those incentives ensure that this type of property is ultimately used for its intended purpose. In contrast, the perpetual ground leases at issue here could very well serve to *increase* the attractiveness of the lake lots around Council Grove Lake to potential lessees who desire to build homes on those lots and know that their real estate taxes are likely to remain low for the entirety of the time that they own their home. The attractiveness of those individual lake lots could therefore have a positive impact upon the property's overall fair market value that would not be fairly considered if only the contract rental rate was used in the appraisal process.

Under the circumstances and with the evidence and arguments presented, the Board concluded that Keller's income approach, as modified, was the best indication of the property's fair market value and was supported by substantial competent evidence. The Board sees no basis on remand to alter its original conclusion. The Board finds that Keller complied with K.S.A. 79-503a when he compared the contractual rent on the lots at issue to the market rents and determined, based upon his appraisal judgment, that usage of the market rents were a more appropriate method to determine the property's market value. The Board further finds the complete appraisal offered by Keller to be the only expert opinion offered that analyzed the relationship between the contract rental rates and market rental rates applicable to the subject lake lots. While K.S.A. 79-503a directs that governmental restrictions upon a property's potential income should be used *in conjunction* with other factors to determine a property's fair market value, the Board does not believe the statute *mandates* that appraisers utilize a below-market contract rental rate to conduct a fee-simple income approach valuation of a property simply because that below-market rate was negotiated by a government body. In other words, the Board does not find that Keller had to *choose* the contract rental rate it issue for use in his appraisal in order to have adequately *considered* it. The Board further finds that use of a market rental rate to

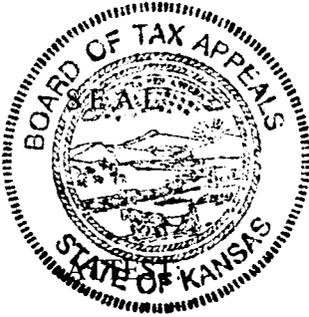
appraise the subject property comports with Kansas law's directive that properties are to be valued in fee simple.

The evidentiary burden in this matter was on the County. The Board holds the County met its burden. The Board reiterates its prior decision on the matter and finds the values of the properties should be set as follows:

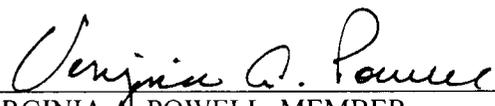
Docket Number	Year at Issue	Parcel Identification Number	Final Value
2014-2160-EQ	2014	064-123-06-1-00-00-010.00-0	\$1,146,000
2016-409-PR	2015	064-123-06-1-00-00-010.00-0	\$1,216,000
2017-879-PR	2016	064-123-06-1-00-00-010.00-0	\$1,326,000
2014-2157-EQ	2014	064-123-07-1-00-00-001.00-0	\$11,995,000
2016-406-PR	2015	064-123-07-1-00-00-001.00-0	\$12,677,000
2017-876-PR	2016	064-123-07-1-00-00-001.00-0	\$14,391,000
2014-2158-EQ	2014	064-123-08-1-00-00-003.00-0	\$3,281,000
2016-407-PR	2015	064-123-08-1-00-00-003.00-0	\$3,517,000
2017-877-PR	2016	064-123-08-1-00-00-003.00-0	\$1,556,000
2014-2159-EQ	2014	064-124-18-1-00-00-005.00-0	\$159,000
2016-408-PR	2015	064-124-18-1-00-00-005.00-0	\$169,000
2017-878-PR	2016	064-124-18-1-00-00-005.00-0	\$384,000

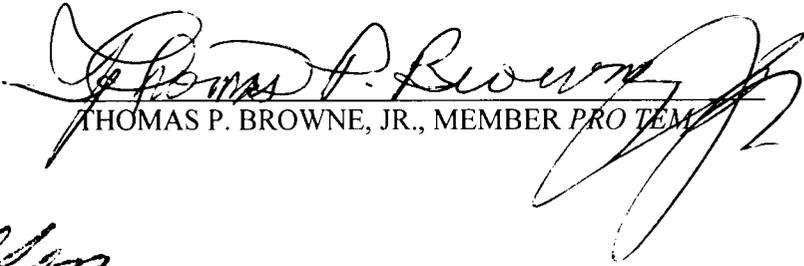
IT IS SO ORDERED.

THE KANSAS BOARD OF TAX APPEALS




KRISTEN D. WHEELER, CHAIR


VIRGINIA A. POWELL, MEMBER


THOMAS P. BROWNE, JR., MEMBER PRO TEM


JOELINE R. ALLEN, SECRETARY

CERTIFICATION

I, Joelene R. Allen, Secretary of the Board of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2014-2157-EQ and any attachments thereto, was placed in the United States Mail, on this 14th day of February, 2023, addressed to:

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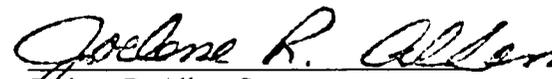
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And on the same date a copy was sent via capitol complex building mail to:

Douglas T. Shima
Clerk of Appellate Courts
Kansas Judicial Center
Topeka, Kansas

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joelene R. Allen, Secretary