

# THE MANAGEMENT OF COMPLEX, HIGH-VALUE PROPERTY TAX APPEALS

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Dealing with complex, high-value appeals can be one of the most difficult duties assessors have. (In this article *assessor* denotes the person with authority over the assessment, although titles and positions vary, and *judge or judges* includes any trier of fact, who may have the title of administrative law judge, hearings officer, magistrate, board member, or other appellation.) In large jurisdictions assessors normally have more help from employees and a larger budget for litigation than in smaller ones, but the responsibility for the outcome normally remains the same—with the person in charge.

I am often retained as a consultant, appraiser, or expert witness by assessors when complex appeals are filed. This article describes some of the experiences and situations that can be encountered as a consultant for complex appeals. The case studies are based on actual cases, but identifying aspects have been removed to retain confidentiality.

## A Reduction without an Appeal

Depending on jurisdictional law, the assessor may have the authority to reduce a valuation without an appeal being filed by the taxpayer. In such cases, the taxpayer may contact the assessor and ask for a reduction without an appraisal. The taxpayer may cite an economic downturn for the industry or explain how profits have diminished for other reasons. The assessor's first reaction may be to resist considering this information because an appeal has not been filed or an appraisal has not been produced. However, it might be a mistake to dismiss this request out of hand. Even though there is nothing compelling the assessor to reduce the valuation at this point, the case being presented should be carefully analyzed.

The reason is that at this juncture the taxpayer may want a fairly modest reduction (or might settle for one), but when the assessor denies the initial request and the appeal is filed,

the reduction requested might increase significantly, causing the chance of settling the case to diminish.

## A Second Opinion

High-value appeals usually involve complex valuation issues, and the more esoteric the issue, the greater the need for a second opinion from an objective party. An unbiased analysis is important not only for the assessor but also for the appraiser who is being reviewed. A review may find errors that can be corrected before the appellant finds them and uses them against the assessor in a hearing. In a complex appraisal there are usually some errors, or at least disputable items that may need more corroboration or explanation. However, there can also be what might be called “fatal errors,” which bring the whole basis of the value conclusion into question.

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Any fatal errors will almost certainly be found by the opposing party, but smaller errors can also make the appraiser appear less credible. Many appraisals that demonstrate solid reasoning are undermined by the communication style used (or not used) in the report. Certain elements may need to be reiterated and explained more fully if the report is to be read by anyone other than expert appraisers who may be able to “fill in the blanks” where communication is lacking. Basically, the appraisal report should be written to be understandable and legitimately persuasive to the judge who reads it. There are many intelligent attorneys, but without specific appraisal training and experience, intelligence alone is not adequate for understanding a complex, specialized report if it is not well communicated.

A professional review appraisal also benefits assessors because it can succinctly state the basic reasons why the opposing appraisal is flawed and why the assessor’s position is valid. In my consulting experience, there have been instances in which assessors deposed as witnesses for a trial were unable to answer when the opposing attorney asked, “How do you know that the assessed value is correct and our request is not reasonable?”

## Valuation Issues to Consider

Another consideration for the assessor is how the value on the roll was determined. Assessment districts often use the cost approach and then trend the reported numbers each year to determine the assessed value. (This is also called the trended investment cost method, trended investment

method, or something similar.) Trends normally increase the value of the original cost to account for inflation and then decrease the value for depreciation. This trending can continue for many years without a market-based appraisal being performed, and the reliability of this approach diminishes the longer it is used. Trends from costing services or a state department of revenue may not include adjustments for economics affecting an industry—particularly issues for a segment of an industry or for the locational aspects of economic obsolescence.

For instance, a trend may cover wood products, but since there are several types of wood product manufacturers, plywood manufacturing may be prosperous whereas sawmills for timber may not. Aluminum production requires a huge amount of electricity, so if rates go up in one part of the country, an aluminum smelter may suffer economically where rates have increased, but not in another location where rates are more stable. The distance between the source of raw materials needed for production and a manufacturing facility could be another issue that trends cannot take into consideration; if the source is distant, the additional cost of shipping may put the manufacturer at a disadvantage.

Industries often experience market swings, meaning that profitability may be down for a year or so and then increase again, and those swings might be typical for the product being manufactured. In such a case, either no value adjustment or perhaps only a very small one may be warranted during a down cycle. On the other hand, a company in an industry experiencing a sustained downturn may be on the verge of going out of business, and its fair market value may be steadily decreasing as the survival of the company becomes questionable.

It is important to understand that when production of an item shifts to China or other low-cost producers around the world, it may signal the death knell of that industry in the United States and elsewhere in the Western Hemisphere. The garment industry is an example: that industry was thriving in the United States until the 1980s, when 95 percent of the manufacturers closed their plants in the United States and moved them to foreign countries with lower wages and less business regulation.

China sometimes specifically targets an industry, and an example is solar panel production. Many U.S. producers of panels shut their doors when panels from China were selling for extremely low prices in recent years. Legislation to stop the dumping (selling below normal production costs) of products such as solar panels may be passed, but countries often find ways around anti-dumping rules. Consequently, it is of paramount importance that industrial appraisers have an in-depth knowledge of the economic condition of the industry under appeal. And again, these conditions may require adjustments not typically reflected in trends.

## The Benefits of an Expert Review Appraiser

The utilization of an expert review appraiser is recommended in hearings because it is awkward for the original appraiser of the facility to critique the appraisal from the opposing side. The main reason is that the appraiser for the assessor has to step out of his or her role a little to perform a full critique, and this may make the appraiser appear as an advocate who is not completely objective. However, since a review appraiser is hired specifically for that task, he or she is expected to compare appraisals, perform a full critique of both, and testify accordingly. This can benefit the assessor if the judge agrees with the analysis, because the judge has to write a decision that explains why the ruling was made, and this normally includes an explanation of the differences in the appraisals. This information will also be presented twice, first in a review report submitted to the tribunal prior to the hearing, and second when the review appraiser testifies in the hearing.

### Helping the Attorney

The expert review appraiser may assist the assessor's attorney in a number of ways. If the expert has litigation experience, he or she may also be able to help write discovery questions and deposition questions. Additionally, the review appraiser may accompany the attorney in depositions and help with further questions, depending on how the appellant's appraiser and others respond to the initial questions. Often the assessor's attorney is from the prosecutor's office and does not have valuation experience, so a consulting expert may help him or her understand the case and applicable appraisal theory. In other situations, the assessor hires a private practice attorney who might have experience in assessment matters. In either situation, the consultant is limited to an impartial view of the case, because he or she is not an advocate for the assessor but an objective advisor. The attorney handling the case, besides having a different role, has a different disposition—the attorney is always an advocate for the client.

### Hiring an Expert Consultant/Review Appraiser

The hiring process should start with asking others for recommendations and requesting CVs or resumes from potential consultants. If the assessor is not certain of the value of the subject property, it is important to tell the consultant that is the case. Some experts automatically begin to take the side of the party who contacts them, and that is not the type of consultant that the assessor needs. Rather, it should be made clear to the expert that the assessor wants an objective, unbiased review and is not just trying to back up the roll value.

When assessors contact me at the outset of litigation, they normally want an objective opinion of the case. I am retained to read whatever appraisals exist and then determine the validity of the appellant's case. Sometimes I conclude that the

requested reduction is reasonable and suggest that the case be settled by granting the appellant's request. In other situations, it may be determined that the case is completely frivolous and no reduction is warranted and no settlement talks are appropriate. In the majority of cases, however, the reduction request has some merit but is overstated, sometimes by a small amount and sometimes by a large amount. The appellant could simply be misguided or the requested value could be predicated on the premise that going in as low as possible is the best strategy with the thought that a settlement or legal decision might end up somewhere in the middle.

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If the request does have merit, I advise the assessor of what a reasonable settlement would be. After that, meetings and discussions take place with the goal of a compromise. Part of the review appraiser's job at this point is to objectively explain to the appellant why the value should not be reduced to the requested amount based on the evidence. However, the review appraiser is not the negotiator. Rather, he or she is there to clarify the appraisal reasons for the settlement being offered so the taxpayer understands the assessor's position. Nevertheless, the appellant may genuinely believe the value is lower than the settlement being offered and prefer to go to court. Court proceedings can be extremely expensive, however, and in many cases rulings can be unpredictable, so a reasonable settlement is generally in the best interests of both parties.

The scenario is quite different if I am called after settlement discussions have failed and a trial appears to be imminent. I may be asked to defend the assessed value and in such cases the potential client is informed that I must do some research to do so legitimately. At this point, some clients decide to go elsewhere, but most send me the requested information and wait for my decision. If I am familiar enough with the industry the decision might be made quickly, but in other situations a small fee is charged before I can commit to the case or decline it.

### Managing Costs

It is relatively inexpensive to have a review appraiser give an opinion on the validity of the competing appraisals, but the expense of going through an entire trial needs to be estimated at the outset. Since most assessors do not have to deal with major litigation on a regular basis, they may be unaware of how costs might be minimized.

First, if an outside attorney is billing by the hour, the normal method of operation is to depose almost everyone involved in the case, which can include company executives, appraisers, review appraisers, and others. As a result, the attorney (and perhaps the expert consultant if he or she has legal training in that area) must travel to different parts of the country, rent an office, hire a court reporter, and conduct the depositions there. To save money in this area, it is useful to determine the most important people to depose. The appraisers involved must certainly be deposed, but often there is no benefit to deposing others, and doing so is extremely expensive. In this area alone, often tens of thousands of dollars can be saved.

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Second, the review appraiser might be involved in choosing an expert appraiser, if an additional appraisal is to be performed, or if an up-to-date appraisal does not exist. The latter situation is often the case if the assessor has only made annual adjustments for the assessment. It is usually not prudent to skimp in this area. Nevertheless, the fees of some appraisal companies are exorbitant. The qualifications of each appraiser being considered should be carefully reviewed, and they should be interviewed on the telephone if they are not known to the assessor. Bids for the appraisals should also include the hourly charges for the appraiser to prepare for the hearing and to testify.

## Case Studies

“Those who cannot remember the past are condemned to repeat it,” wrote George Santayana in 1905 (Santayana 1996). Case studies can teach us to avoid mistakes of the past. The following examples are based on actual cases, or a composite of cases, but the incidentals have been changed for confidentiality reasons.

### A Power Generation Appeal

This appeal was a major issue for the somewhat rural county in which it occurred, because the power generation facility was its largest taxpayer. The facility was new, but operating only partially because of an overabundance of power at that particular time. It was scheduled to ramp up in the coming year, but there was still a request for a major reduction of more than \$200 million in assessed value.

I was retained by the senior prosecuting attorney for the county as a consultant and review appraiser. We hired an

outside appraiser to perform an appraisal, and I was going to testify as the review appraiser. However, the appellant’s appraisal quoted and relied heavily on the book *Valuing a Business* (Pratt with Nicullta 2008). That book has set the international standard for valuing businesses, and it became clear that the appraisal had a number of problems that Dr. Pratt might have considered improper and that might have led the appraiser to an erroneous value conclusion.

I knew Dr. Pratt personally and called him and asked him to examine the appraisal and tell me if he agreed with my analysis of it. He said he agreed, and would do a review of it and testify if we wanted him to do so. I told the deputy prosecutor that Dr. Pratt was a better choice for a review appraiser than me, and that since he was quoted about eleven times throughout the appellant’s appraisal, I thought he would be very effective in the trial.


We met with some resistance getting approval for the additional funds that were necessary because Dr. Pratt was considerably more expensive than I was, and the budget had to be increased. I had to explain that with the amount of tax dollars at stake, it was important to use him, and that we were fortunate to have a man of his stature and expertise available. I knew it would be a powerful defense to have the author of the book the appraiser quoted testify that the appraiser was in error. After upper management understood this, they agreed.

The case was won without any reduction being granted to the appellant.

### A Paper Mill Appeal

The assessment of a paper mill was being appealed, and several years had gone by, bringing the assessment differential into the millions of dollars of actual taxes paid. There was palpable animosity between the assessor and his appraiser and the company, and the reason soon became apparent. The mill was old—it actually began operation about 1900, and many of the machines were narrow, making them obsolete. Newer paper machines are much wider and more efficient than older machines. Nevertheless, the mill had a niche and was profitable. The mill hired an appraiser who performed a discounted cash flow (DCF) valuation, in which profits from the predicted future are used to determine the current value. In some states this type of valuation is not allowed in a contested assessment case, but in this particular state it is.

The assessed value of the mill was about \$390 million, and the DCF-purported value was \$200 million. The valuation report was only a few pages and was given to the assessor with a request for a reduction to that amount. There was no backup information, and it was not in an appraisal format.



The assessor's industrial appraiser called the company and made an appointment to visit the plant and revalue it. He took with him other staff who generally do not do industrial work, and they spent a week inventorying everything they could including not only the machinery and equipment but also the buildings, which were specialized structures for paper manufacturing. With that information, the industrial appraiser performed an appraisal using only the cost approach. He trended the original costs that were on the books, and for items for which no original costs were recorded, he estimated new costs and depreciated them.

When the appraiser finished this laborious task, he concluded that the value was not the original assessed value of \$390 million, but \$541 million. The problem with his appraisal was clear: the value of the mill was market driven, and trending older equipment and buildings, especially as old as these were, was not a method by which an appraiser could reach the fair market value. It would be like someone valuing an old house by adding up the cost of all the building materials and trending them, without considering the market conditions of the neighborhood.

In any event, the assessor's appraiser did not contact the paper mill management, but stayed quiet about the new value. The company only found out at the time value change notices were sent, and when management got this substantial increase, they were livid. When I entered the picture, angry exchanges had already taken place, and neither side was considering a settlement. Instead they had both retained legal representation and the assessor had an outside appraiser perform another DCF valuation, which mostly confirmed the new value.

The new DCF valuation was performed by a college professor with a doctorate in finance who worked exclusively on the government side of assessment disputes. I was curious about his projection, because he based it on the paper mill's profits increasing by 7 percent every year for 20 years into the future. I had never observed such an optimistic projection, especially on a mill with obsolete paper machines. Through the process of discovery, we then received the backup information on the company's appraisal. From that information, it became apparent that the appraiser for the mill had made many mistakes. His choice of a discount rate was poorly supported, and other errors made his value conclusion problematic.

The professor who performed the DCF valuation for the assessor could not quite get to \$541 million, but he was close, and as I analyzed his appraisal, it was clear that he had not taken out working capital. The question arose whether this was a huge mistake from someone with excellent credentials or whether there was some other explanation. The professor ended up saying that he did not know where it went. "Where

did it go?" he answered, when questioned. This response was unusual because although there are a few exceptions, it is a rather well-accepted finance theory that working capital should be taken out of a DCF valuation for a facility such as this one.

The difference between \$200 million and \$541 million may seem large, but over the years I have come to expect this wide variation in appeals.

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I once reviewed and testified in a case in which two experts were about \$1 billion apart with a DCF—the assessment was \$1.2 billion and the request was for \$225 million. In another situation, for a wood products company, the appraiser for the taxpayer provided several scenarios to his client with different values, asking which one he liked. The e-mail was mistakenly sent not only to his client but to me as well when he evidently clicked "reply all." The bottom line is that these wide variations using income approaches such as DCF are to be expected, and should therefore be corroborated with other valuation approaches to determine their validity.

In the paper mill case, the professor working for the assessor never saw the paper mill. When asked why he did not tour the plant, he replied that there were no discount rates for the machines, meaning that he thought that seeing the facility was a waste of time. It actually might have been a waste of time for him, as it is doubtful that he had any technical knowledge of the paper mill industry outside of the financial aspect. But in reality a good appraisal could not be conducted without specific knowledge of the plant—and that would require a thorough examination of the facility. One mistake was that the future prediction did not take into consideration the obsolescence of the narrow paper machines. They were profitable at the time of the appeal, but they had an uncertain future, and one new paper machine could cost anywhere from \$100 to \$500 million to purchase and install.

Another issue was the location of the mill. That particular area of the country had very high union labor costs, and no paper manufacturer would have started a new mill there. Moreover, when the 100-year-old mill was built, it was isolated. However, a city had grown around it, and there were constant complaints about the odor and emission of fumes, which is a headache no manufacturer wants to deal with.

Therefore an adjustment for the location was necessary for an accurate valuation.

The mill also had an older recovery boiler, with about 12 years of life left. The cost to rebuild that boiler was about \$70 million, and this raised the question of how many years the mill would continue to operate. Would this portend a future with an increase of 7 percent a year for the next 20 years as the professor predicted, or would the mill shut down because it was less cost-effective to operate and further investments would take too long to recoup?

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During a meeting with the mill staff, the manager told me that receiving the value increase from the assessor without any explanation was “like a poke in the eye,” and I understood the animosity between the two parties was a major detriment to a settlement. However, it also became clear why the assessor was angry after I met with the attorney representing the mill and the appraiser he had recommended. In my conversation with them, their attitudes were condescending and provoking.

The controller at the company had been pleasant during my brief interactions with him, so I called him and asked whether we could discuss the matter directly or was it solely in the hands of the company’s attorney. Once a company has legal representation, the review appraiser might not be allowed to talk to them directly, but the assessor had not been restricted at that point. He said he would meet with me and discuss the matter.

Having already researched paper mill sales and performed my own DCF, I had concluded that the value of the subject property was too high at \$541 million and too low at \$200 million. I met with the assessor and explained to him the flaws in both appraisals and told him the number I had in mind for a settlement.

After listening to the explanation, the assessor agreed that the settlement amount was reasonable, but he questioned whether the company would consider a settlement. I then explained that the controller for the company was bypassing the attorney and that we had scheduled a meeting. I also related the company’s view of the issues and explained that the company attorney and appraiser were part of the reason for the animosity.

After the meeting to discuss a settlement, the controller agreed to the value offered by the assessor, and the mill withdrew the appeal.

## Summary

In summary, the management of complex, high-value appeals will benefit from recruiting an expert review appraiser to manage the mix of options that can be pursued, and help the assessor determine the validity of the appeal. If the review appraiser also has the skill set to be of assistance in litigation, this will provide assistance for the assessor’s attorney. Appeals take on a life of their own, so the experience and technical knowledge of the review appraiser are probably the most important consideration. Selective cost management during the appeals process is another potential benefit, if the review appraiser has knowledge in this area. In the interview process, the assessor should determine what services the review appraiser can provide, and determine how useful and articulate he or she will be in preparing for the hearing and testifying.

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