IN THE COURT OF APPEALS OF IOWA

No. 0-429 / 09-1453
Filed October 6, 2010

JCO PROPERTIES, INC.,
An Iowa Corporation,
Plaintiff-Appellant/Cross-Appellee,

vs.

THE BOARD OF REVIEW FOR
SCOTT COUNTY, IOWA,
Defendant-Appellee/Cross-Appellant.

Appeal from the Iowa District Court for Scott County, Gary D. McKenrick, Judge.

A taxpayer appeals from a district court ruling establishing the assessed value of lots. **AFFIRMED.**

Candy K. Pastrnak of Pastrnak Law Firm, P.C., Davenport, for appellant.

Robert L. Cusack, Davenport, for appellee.

Heard by Vogel, P.J., and Doyle and Mansfield, JJ.

MANSFIELD, J.

A developer appeals the district court's decision valuing certain lots for the 2007 and 2008 property tax years. The developer argues the district court should have accepted the testimony of its experts discounting the market values of those lots by approximately twenty to thirty-three percent considering the time it would take to sell those lots. We agree with the district court that the "absorption discount" proposed in this case is not an economically sound concept. We also believe it is not supported by Iowa law. Thus, we concur with the district court's decision to "discount the discount" and affirm its valuations and judgment.

I. Background Facts and Proceedings.

This case involves a taxpayer's consolidated appeals from decisions of the Scott County Board of Review (Board). JCO Properties, Inc. (JCO) owns fifty vacant residential lots in two subdivisions—twenty-seven lots in Pebble Creek North and twenty-three lots in Pebble Creek South.[1] These lots were platted in 2003 around a nine-hole public golf course, Pebble Creek Golf Course, with the north plat consisting of 113 lots and the South plat consisting of twenty-seven lots. JCO purchased the lots that are the subject of this appeal in 2004 and 2006.

In 2007 and 2008, the county assessed these lots at valuations ranging from $81,600 to $173,660. In both years, JCO was dissatisfied with the county assessor's valuations and filed a protest with the Board claiming (1) the

[1] JCO owns Lots 15, 17-32, 35, 39, 41-48 of Pebble Creek North and Lots 1-6, 9-18, 20-22, and 24-27 of Pebble Creek South.

assessments were not equitable as compared with assessments of other like property in the city or county, and (2) the properties were assessed for more than the value authorized by law. *See* Iowa Code § 441.37(1)(a), (b) (2007) (providing the grounds for protesting a county assessor's valuation). After an oral hearing, the Board upheld the assessments.

JCO appealed to the district court, where the appeals were consolidated on October 8, 2008. In the consolidated appeals, JCO challenged the 2007 and 2008 assessments on the same grounds raised before the Board. *See id*. § 441.38(1) (providing that on appeal to the district court, the taxpayer is limited to the grounds raised before the board, but may introduce evidence in the district court to sustain those grounds). Additionally, JCO raised a further objection to the 2008 assessment, asserting "there had been a change downward in the value since the last assessment based on the rather extensive absorption timeframes associated with the subdivision."

Trial was held on April 28, 2009. Three appraisers testified: David Mark Nelson, Robert McGivern, and Douglas Hattery. Nelson and McGivern were called by JCO as its two disinterested witnesses. *See* Iowa Code § 441.21(3). The three appraisers' ultimate valuations differed from one another. Unsurprisingly, Nelson's and McGivern's valuations were significantly lower than Hattery's.

Nelson testified that he employed two appraisal methods—market value and discounted value. To determine the market value of the lots, Nelson considered comparable sales. He did not rely upon any sales of lots within the Pebble Creek development because he believed they were all business

transactions between a real estate developer and a homebuilder. Instead, Nelson considered sales from other developments. Under his approach, Nelson found the market value of the north lots ranged from $61,864 to $77,637 and that of the south lots from $109,967 to $244,437.

Having determined market value, Nelson then arrived at a discounted value by adjusting the market value to account for the length of time it would take for the lots to be sold. Nelson explained he "went further than just the comparable sales and developed a discounting analysis in order to truly develop the cash equivalency and the current value of those lots." Nelson elaborated:

> [T]here are not sufficient buyers and sellers within the market to absorb the lots that are—the numerous, significant number of lots that are available. And it is my opinion in looking at these subdivisions in both 2007 and 2008 that the absorption periods would be significant on the South side. With the values that I put on the properties, it would be my opinion it would take eight years for all of those lots to be sold. And on the North side it would be . . . my opinion it would take ten years for all of those lots to be sold.

Thus, Nelson found the ultimate value of the north lots ranged from $41,758 to $52,405 and that of the south lots from $82,475 to $183,328. To get to these numbers, Nelson essentially discounted the market values he had calculated for the north lots by 32.5% and those for the south lots by 25%.

McGivern used similar basic methods, but arrived at different values. Initially, to determine market value, he considered sales within Pebble Creek, accounting for the fact that they were between a real estate developer and home builder. McGivern also considered comparable sales from other developments. He found the market value of the north lots ranged from $60,000 to $80,000 and that of the south lots ranged from $100,000 to $220,000. Additionally, like

Nelson, he then applied an absorption rate to reach a discounted value, calculating different discounted values for 2007 and 2008. McGivern justified his absorption rate as a way of accounting for the cost of a real estate developer holding onto the property in order to sell it for the highest price possible over a period of years. McGivern's discount rates were 20.75% for the north lots for 2007, 27.41% for the north lots for 2008, 27.41% for the south lots for 2007, and 33.31% for the south lots for 2008.

Hattery, who had been retained by the Scott County Assessor, testified as to the market value of the lots, without an absorption discount. Like Nelson and McGivern, he used a comparable sales approach. However, whereas Nelson disclaimed reliance on any prior sales within Pebble Creek, Hattery considered several such sales, explaining that they were not from developer to builder but actually were to individuals. Thus, in his calculations of market value, Hattery considered three sources—list prices in Pebble Creek, prior actual sale prices in Pebble Creek, and comparable sales in other subdivisions. He also took into account the availability of buyers. Hattery found the market value of the north lots ranged from $80,000 to $96,000 and that of the south lots ranged from $150,000 to $350,000. He did not use an absorption discount to determine the market value of the lots because, in his view, the market price already accounted for the availability or unavailability of buyers. Hattery explained:

> Discounting doesn't have to do with unsaleability. Discounting has to do with looking at a way to bring back to present value an investment of something that happens over time, okay? It doesn't—it is not a tool that is designed to give you an individual lot value today.

Dale Denklau of the Scott County Assessor's Office also testified. According to Denklau, in determining assessed value, the assessor's office gave weight to the declarations of value that had been filed for sales that had actually occurred in these subdivisions. Denklau also testified that the absorption discount is not generally used in making assessments in Iowa.

On June 10, 2009, the district court issued its decision. In a thorough opinion, the district court found both parties had presented testimony and appraisal reports in support of their positions, but that the principal dispute was whether the concept of absorption should apply and to what extent. The district court further found,

> The failure of the assessor or the board of review to consider an absorption discount in arriving at the market value for the subject lots was error. Therefore, this Court, in its determination of the issues anew under section 441.39 of the Code, will consider the application of an absorption discount in the determination of the market value of the lots at issue.
>
> The consideration of an absorption discount, however, does not equate to a blind acceptance of the evidence proffered by the appellant on that issue. Nor does consideration of the concept of an absorption discount mean application of an absorption discount on any particular lot or groups of lots.
>
> The knowledgeable and informed subdivision developer (seller in the context of the assessment statute) knows that some amount of time will pass as the market absorbs the lots being created by the developer. That knowledge inheres in the developer's planning and in the developer's determination of the prices at which the lots created will be listed.
>
> Basic economic theory indicates that an increased supply of a product, such as vacant residential lots, would result in a lower price for the product at the point of market equilibrium. The seller can choose to maintain prices at a greater level than market equilibrium, thereby extending the time period over which the supply of lots will be absorbed. Alternatively, the lot prices could be set at a lower, market-clearing level. Thus, the developer has some control or input into the length of time necessary for the market to absorb the increased supply. One presumes in our free market society that the seller will price the product so as to

> maximize the seller's return on the seller's investment, giving full consideration to the time value of money. Thus, the list prices of the lots are relevant evidence of the owner's calculation of the time value of money, though certainly not controlling evidence.
>
> The appellant presented the testimony of two real estate appraisers, each of whom calculated a market value for each of the subject lots based on a comparable sales approach and each of whom then estimated a market absorption time period and resultant discount rate which then was applied to arrive at a "present" market value of each of the subject lots. The appellant also provided the Court with a proposed assessment value for each of the subject lots. The appellee presented the testimony of a real estate appraiser who calculated a market value for each of the subject lots based on a comparable sales approach and without any regard for any absorption discount. The Court also had before it the assessed values of each of the subject lots as determined by the appellee. . . . .
>
> . . . .
>
> In considering the foregoing evidence, the Court is unable to accord significant credibility to the absorption discounted values presented on behalf of the appellant. Although the rationale and analysis given by the real estate appraisers in support of their opinions is highly professional and facially impressive, the ultimate calculation and result is highly speculative in the determination of an appropriate length of time for the market absorption to occur and of an appropriate percentage discount to be applied. Both in turn are dependent on the list pricing determinations made by the appellant. Therefore, the Court is compelled to discount the discount. The Court notes that even the appellant has discounted the appraisers' absorption discount by virtue of its proposed valuations of the subject lots being closer to the appraisers' undiscounted estimates of the market values for the lots.

The district court then found no appreciable difference in the values of the lots had accrued between January 1, 2007, and January 1, 2008. Considering all the evidence, it assigned values to the north lots ranging from $68,000 to $83,000 and to the south lots ranging from $125,000 to $220,000.

JCO appeals, challenging the district court's valuations of the lots. The Board cross-appeals, taking issue with the district court's use (albeit limited) of an "absorption discount."[2]

II. Standard of Review.

The case was heard in equity; thus, our review of the district court's decision is de novo. *See* Iowa Code § 441.39; Iowa R. App. P. 6.907. "Although we give weight to the fact-findings of the trial court, we are not bound by those findings." *Soifer v. Board of Review*, 759 N.W.2d 775, 782 (Iowa 2009). "We are especially deferential to the court's assessment of the credibility of witnesses." *Boekeloo v. Board of Review*, 529 N.W.2d 275, 276 (Iowa 1995).

III. Legal Analysis.

JCO challenges the district court's valuations and asserts the court should have accepted the testimony of its experts, especially as regards the absorption discount. The Board responds that an absorption discount should not be used and requests we affirm the district court's valuations. Notably, if one puts aside the absorption discount claim, the values assigned by the district court for the lots are much closer to the numbers presented by JCO's experts than to those provided by the Board's expert. Nelson calculated a range of $109,967 to $244,437 for the south lots and $61,864 to $77,637 for the north lots; McGivern calculated a range of $100,000 to $220,000 for the south lots and $60,000 to $80,000 for the north lots; and Hattery calculated a range of $150,000 to

[2] Although the Board has cross-appealed, it does not appear to argue anywhere in its brief that the district court's final valuations of the lots were incorrect. In its concluding paragraph, it actually asks us to find "that the district court was correct in its valuations of the subject properties."

$350,000 for the south lots $80,000 to $96,000 for the north lots. The district court found the appropriate values for both years were $125,000 to $220,000 for the south lots and $68,000 to $83,000 for the north lots.

A. General Legal Principles.

Iowa Code chapter 441 sets forth the relevant statutory framework for the assessment and valuation of property. Section 441.21(1) provides that all property subject to taxation must be "valued at its actual value," which is the "fair and reasonable market value of [the] property." Iowa Code § 441.21(1)(a), (b). JCO protested the assessor's valuation with the Board, alleging the lots were assessed above their market value. *See id*. § 441.37 (authorizing a property owner dissatisfied with the county assessor's valuation to protest the assessment to the board of review and providing the grounds upon which the protest may be made). The Board upheld the assessor's values, and JCO appealed to the district court where it again asserted the assessor's values were in excess of the market value, and argued that an absorption discount should apply. *See id*. § 441.38 (authorizing appeal to the district court on the limited grounds raised before the board and providing the taxpayer may introduce evidence in support of those grounds).

JCO has a twofold burden on appeal. *See Boekeloo*, 529 N.W.2d at 276 (citing *Heritage Cablevision v. Board of Review*, 457 N.W.2d 594, 598 (Iowa 1990)).

> First, the property owner bears the burden to prove that an assessment is excessive. *Heritage Cablevision*, 457 N.W.2d at 598; Iowa Code § 441.21(3) (1993). Second, the appealing party "must establish what the correct valuation should be." *Heritage Cablevision*, 457 N.W.2d at 598; *accord Milroy v. Board of Review*,

> 226 N.W.2d 814, 818 (Iowa 1975). If the property owner "offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor," the burden of proof shifts to the board of review to uphold the assessed value. Iowa Code § 441.21(3) (1993).

Id. at 276-77. "If the taxpayer fails to offer competent evidence of two disinterested witnesses, then the burden of persuasion remains with the taxpayer to establish that the assessed valuation was excessive." *Soifer*, 759 N.W.2d at 780.

Iowa Code section 441.21 provides the following guidance on determining the market value:

> *"Market value" is defined as the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller*, neither being under any compulsion to buy or sell and each being familiar with all the facts relating to the particular property. Sale prices of the property or comparable property in normal transactions reflecting market value, and *the probable availability or unavailability of persons interested in purchasing the property, shall be taken into consideration in arriving at its market value*. In arriving at market value, sale prices of property in abnormal transactions not reflecting market value shall not be taken into account, or shall be adjusted to eliminate the effect of factors which distort market value, including but not limited to sales to immediate family of the seller, foreclosure or other forced sales, contract sales, discounted purchase transactions or purchase of adjoining land or other land to be operated as a unit.

Iowa Code § 441.21(1)(b) (emphasis added). Further, if the market value of the property cannot be established using the identified methods, "then the assessor may determine the value of the property using the other uniform and recognized appraisal methods." *Id.*

B. The Evidence Supports the District Court's Valuations.

JCO first asserts the evidence does not support the district court's valuation of the lots. Three qualified appraisers testified for the parties—two in support of JCO (Nelson and McGivern) and one in support of the Board (Hattery). All three appraisers estimated market values based on permissible factors, such as actual sales of the lots, listing prices of the lots, comparable sales in other subdivisions, and availability of buyers. *See* Iowa Code § 441.21(1)(b). Although the appraisers disagreed as to whether some sales could be considered comparable, each of them gave plausible reasons for their conclusions.

All three appraisers, including JCO's appraisers, reached the conclusion that some market values were higher and some were lower than the assessed values. For example, the assessed value of Lot 1 in Pebble Creek South was $166,920, whereas Nelson's assigned market value was $130,691, McGivern's was $120,000, and Hattery's was $160,000. On the other hand, the assessed value of Lot 9 in Pebble Creek South was $171,710, whereas Nelson's estimated market value was $244,437, McGivern's was $220,000, and Hattery's was $350,000. Ultimately, the district court valued these two lots at $137,000 and $220,000, respectively. For each lot, the district court was presented with conflicting evidence as to the market value. We find the district court's painstaking efforts to value these properties fully supported by the evidence and adopt the values as our own.

C. The District Court Properly Declined to Follow the Views of JCO's Experts Regarding an Absorption Discount.

Next, JCO essentially argues that the district court should have accepted its appraisers' opinions regarding absorption discount. This discount, as JCO's witnesses explained, is intended to account for the time it will take for all the lots to be sold, given that "money. . . coming in [a] substantial or significant point into the future. . . is worth less than money coming to me today, and I need to discount for that . . . time value of money . . . ." We disagree with JCO's contention for several reasons.

First, as the district court observed in its well-reasoned opinion, "basic economic theory" dictates that these considerations should be incorporated into the market price of the properties. If there is a large supply of properties available, then all things being equal, their prices should be lower. For example, according to JCO's expert Nelson, Lot 1 in Pebble Creek South, for which the owner was asking $140,000, had a market value of $130,691 but should really have been assessed at $98,018. That is because, according to Nelson, it would take four years to sell the lot for $130,691, and $130,691 four years from now is worth the same to the developer as $98,018 today. If those things are true, however, we would expect the developer to be willing to accept anything above $98,018 for the property today. In other words, the true market value of the property is $98,018, not $130,691 (or the developer's asking price of $140,000). If the developer would prefer not to accept $98,018 and to hold onto the property, then this indicates Nelson has overstated the time value of money and/or understated the true value of the property.

We put the matter another way: To determine the market value of property based on considerations of supply and demand, and then to discount that market value further—again based on the same considerations—strikes us as an unsound application of economic theory.

Furthermore, as the district court pointed out, a number of courts in other jurisdictions have expressed skepticism about absorption discounts. For example, in *Board of Equalization of Salt Lake County v. Utah State Tax Commission*, 864 P.2d 882, 886-89 (Utah 1993), the court held that application of an absorption discount would be an "administrative nightmare," would violate a state constitutional provision requiring uniformity in taxation, and would contravene the property assessment statute. *See also Hixon v. Lario Enters.*, 875 P.2d 297, 300-01 (Kan. Ct. App. 1994) (rejecting a developer's discount on the grounds that it violated the constitutional requirement of uniform and equal basis of valuation and resulted in unequal treatment of owners of similar lots); *St. Leonard Shores Joint Venture v. Supervisor*, 514 A.2d 1215, 1217 (Md. 1986) (rejecting consideration of a "sell-out" period and stating, "Regardless of whether a buyer for each lot actually exists, the assessor is required to assess each lot *as if* a willing buyer exists. This is not to say that a glut on the market should not be considered. We think, however, that the condition of the real estate market is adequately reflected in the price that the hypothetical buyer would be willing to pay."); *Mathias v. Department of Revenue*, 817 P.2d 272, 273 (Or. 1991) (holding unconstitutional a statute that provided for valuation of multiple lots "under a method which recognizes the time period over which those lots must be sold in order to realize current market prices for those lots").

As noted by the district court here, a New Jersey case, *Tamburelli Properties Association v. Borough of Creskill*, 705 A.2d 1270, 1273-75 (N.J. Super. App. Div. 1998), did approve the use of an absorption discount. But it did so only because the property in question was being valued for residential purposes even though it had not yet been subdivided and the anticipated lots had not yet been put on the market. The court distinguished earlier New Jersey cases that had refused to apply an absorption discount to properties that had already been subdivided and marketed. The *Tamburelli* rationale makes sense to us. Once a lot has been carved out as a distinct unit for taxation purposes, the assessor's job is to value that unit on its own. A developer owning multiple lots should not be able to reap a benefit for taxation purposes that an individual owner of the same lot would not be able to realize.

Lastly, and most importantly, we do not believe the general assembly has authorized the use of an absorption discount in determining assessed valuation for property tax purposes. Under section 441.21(1)(b), market value is "defined as the fair and reasonable exchange in the year in which the property is listed and valued between a willing buyer and a willing seller . . . ." Thus, the presence of a willing buyer and a transaction *that occurs in the year in question* are both presumed for assessment purposes. The legislature also directed that "the probable availability or unavailability of persons interested in purchasing the property, shall be taken into consideration in arriving at its market value," but availability or unavailability of buyers normally enters into any proper determination of market value. It is part of the demand curve, whose intersection with the supply curve gives one the market-clearing price.

Thus, under section 441.21(1)(b), we have to assume the sale would occur in the valuation year, not in a subsequent year as posited by Nelson and McGivern. We also have to calculate market value taking into account the availability or unavailability of buyers, not adjust market value afterward as Nelson and McGivern did. Their methods simply cannot be squared with the clear language of the statute.

Thus, we agree with the district court's decision to "discount the discount." The concept of an absorption discount to be applied to market value has only limited, if any, usefulness in property tax valuations. We also agree that the district court's valuations for assessment purposes are well within the range of the expert testimony and do not warrant further reduction by this court.

D. JCO's Claim that the District Court Lacked Authority to Increase Property Valuations Has Been Waived.

In its reply brief and at oral argument, JCO maintained that the district court also erred in increasing some of the property valuations even though the Board did not appeal the assessments to the district court under section 441.42.[3] JCO did not raise this argument before the district court, nor in its main brief to us. "[W]e have long held that an issue cannot be asserted for the first time in a reply brief." *Young v. Gregg*, 480 N.W.2d 75, 78 (Iowa 1992).

At oral argument, JCO insisted the issue was jurisdictional and could be raised for the first time in an appellate reply brief. We disagree. JCO concedes that section 441.43 on its face appears to give the district court authority to

[3] These increased valuations generally involved situations where the market values offered by one or both of JCO's own experts in his testimony (before the absorption discount) were above the county's 2007-08 assessments.

"increase, decrease, or affirm the amount of the assessment appealed from," regardless of who appeals, yet JCO cites to judicial decisions interpreting section 441.43 as not allowing the party who fails to appeal an assessment to benefit from the appeal. *Central Life Assurance Soc'y v. City of Des Moines*, 212 Iowa 1254, 1261, 238 N.W. 535, 538 (1931); *see also Excel Corp. v. Pottawattamie County*, 492 N.W.2d 225, 230 (Iowa Ct. App. 1992). Still, whatever the merits of this judicial interpretation of section 441.43, it is at most a limit on the authority of the court to take a particular action, which can be waived, not on the subject-matter jurisdiction of the court to hear a particular case, which cannot be waived. *See Alliant Energy-Interstate Power & Light Co. v. Duckett*, 732 N.W.2d 869, 874 (Iowa 2007). Therefore, we find JCO has waived this issue and do not address it on appeal.

For the foregoing reasons, we affirm the judgment of the district court.

AFFIRMED.