PROPERTY TAX APPEAL BOARD'S DECISION

APPELLANT: Countryside Healthcare Center, L.P.
DOCKET NO.: 04-00988.001-C-3
PARCEL NO.: 15-19-176-009

The parties of record before the Property Tax Appeal Board are Countryside Healthcare Center, L.P., the appellant, by attorneys Allen A. Lefkovitz and Frederick F. Richards III of Allen A. Lefkovitz & Associates, in Chicago, Illinois; the Kane County Board of Review; and City of Aurora, the intervenor, by attorneys Stuart L. Whitt and Joshua S. Whitt of Whitt Law, in Aurora, Illinois.

The subject property is improved with a two-story, masonry constructed 207-bed nursing home containing 95 rooms built in 1972. The improvement contains 60,275 square feet of building area and is situated on a concrete slab. The building has a 100% wet sprinkler system. The property also includes approximately 22,000 square feet of asphalt driveway and approximately 6,860 square feet of concrete paving. The improvement is situated on a 130,680 square foot or approximately 3 acre site in Aurora, Aurora Township, Kane County, Illinois.

The appellant appeared before the Property Tax Appeal Board through counsel contending overvaluation as the basis of this 2004 assessment appeal. In support of that argument, appellant submitted a legal brief, an appraisal which estimated a fair market value of the subject property as of January 1, 2003 of $4,000,000, and also presented supporting testimony by the appraiser who prepared the report and a member of management of the subject nursing home property.

The appellant's first witness was real estate appraiser John W. Van Santen, who is currently employed by Wellspring Valuation as a senior vice president and real estate practice leader; this company's sole focus is on health care related properties. From April 2006 to April 2007, Van Santen has appraised well over 100 nursing homes across the United States. Van Santen was

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Based on the facts and exhibits presented, the Property Tax Appeal Board hereby finds *an increase* in the assessment of the property as established by the **Kane** County Board of Review is warranted. The correct assessed valuation of the property is:

LAND:	$ 205,917
IMPR.:	$ 1,683,291
TOTAL:	$ 1,889,208

Subject only to the State multiplier as applicable.

PTAB/cck/1-15

previously employed by Real Estate Analysis Corporation (REAC), and was one of the preparers of the appellant's appraisal report. Van Santen had been employed with REAC for approximately five years where he was vice president of real estate analysis. While with REAC, the appraiser appraised a wide range of industrial and commercial properties. Van Santen has been licensed by the State of Illinois as a Certified General Appraiser and he is a member of and has taken the courses necessary to hold an MAI designation from the Appraisal Institute; he has also published papers and spoken on valuation of health care properties before the International Association of Assessing Officers (IAAO). Van Santen has taken courses from the Appraisal Institute specific to the instant appraisal task addressing separating intangible business value from the real estate and courses specific to the valuation of nursing homes. Without objection, the witness was accepted as an expert.

The appraiser inspected the subject property on June 18, 2004 and used the three traditional approaches to value in estimating the subject's market value for real estate only, excluding business value and personal property. Van Santen along with other members of the REAC firm prepared a complete appraisal in summary-reporting format. The assignment herein was to perform a fee simple market value appraisal of the subject as of January 1, 2003.

Under the cost approach, the appraiser estimated the subject's value as $3,700,000, rounded. To develop the land value, six vacant land sales in the Aurora, Illinois area were used. They were subsequently used for or planned for use for town homes and/or single family residential development, except one intended for commercial development. These properties ranged in size from 89,995 to 3,267,000 square feet of land area and they sold from April 2000 and December 2003 for prices ranging from $588,000 to $5,800,000 or from $0.47 to $10.56 per square foot of land area. Although a majority of the land sizes are significantly larger than the subject property as depicted on a chart on page 75 of the appraisal report, the appraiser primarily made positive adjustments to the sale prices due to differences in size and also location with some consideration given to zoning. Based on these adjusted sale prices, the appraiser concluded a market value of $7.00 per square foot for the subject land or $915,000, rounded.

Next, the appraiser determined a replacement cost new for the subject improvement of $120.16 per square foot of building area utilizing the RS Means Cost Manual in addition to considering additional publications. Van Santen found the improvement to be in average to good condition meaning that it has been maintained to market standards, namely, what the market is currently or typically demanding in terms of a nursing home within that particular marketplace. In calculating the replacement cost, Van Santen assumed a building size of 59,041 square feet which is more than 1,200 square feet less than the subject's actual size as stipulated by the parties at the hearing. The appraiser arrived at a total estimated replacement cost new of $7,339,166 which includes site improvements of $244,821 and indirect costs, but not entrepreneurial profit according to testimony by Van Santen.

Although he did not account for it in his appraisal, Van Santen testified that entrepreneurial profit was, first, different from developer's profit,[1] and second, was a market derived figure over and above the actual cost, including all indirect and direct costs which go into building a property. Van Santen went on to testify that the concept, in his opinion, was not applicable for a special use property such as a nursing home which was built for a specific use to a specific owner's design requirements. In coming to this conclusion, Van Santen further relied upon the Medicaid reimbursement rates which factor in a capital cost component essentially providing for a rate of return on the land and building associated with the property.

The appraiser used the age/life method to calculate physical depreciation. No functional or external obsolescence was noted according to the appraisal report. In his testimony, Van Santen defined effective age of the property as the perception of a facility in terms of its condition relative to what the market is looking for; the level of maintenance generally is what affects effective age from actual age. As further explained, if a property has been generally maintained to the same standard as other nursing homes in the area, typically its effective age would be the same as the actual age; alternatively, if it is maintained much better than other facilities within the marketplace, the effective age may be less than the actual age. In this case, Van Santen found the improvement for purposes of effective age to be consistent with its actual age of 31 years. He further found its remaining economic life to be 19 years. Physical depreciation of 62% based on a standard age/life method (effective age of 31 divided by the total economic life of an opined 50 years) was provided of $4,550,283 resulting in a depreciated value of improvements of $2,788,883. The total estimate of value under the cost approach rounded is $3,700,000.

Under the income capitalization approach, as stated in his testimony, Van Santen examined historical income and expenses for the subject property for years 2000 through 2002 (see Exhibit A on page 88 of his Report), although at another point his report erroneously indicated the income data came from years 1999

[1] Developer's profit is included in those costs as a normal part of the normal cost of constructing a property. (TR. 33)

through 2001 (Report p. 87). In addition to these actual income figures, Van Santen examined industry norms and expense ratios from comparable nursing homes to arrive at gross estimated income of the going concern.

He also analyzed the payor mix for the property and found the majority of the occupancy, over 64% of the total patient days, consisted of Medicaid patients (Report, p. 89). Van Santen explained that the Medicaid rate for each nursing home consists of three components: nursing care; supportive services such as food, laundry and related non-direct care costs; and capital cost which includes mortgage interest and asset depreciation. (Report p. 23, 53-54) According to Van Santen, the Medicaid rate is not a market based rate. The Illinois Department of Public Aid establishes the rate based on sworn nursing home cost reports reflecting the actual expenses of the facility.

For years 2000 through 2002, the subject's occupancy ranged from 87.3% to 96.7%. Van Santen opined the current high occupancy rate of the subject is due to several factors including that it offers a much higher level of service with regard to patient acuity (intensive level of care) than other nursing homes in the area and that it has a contract in place with an insurance company for discharge referrals. Additionally, Van Santen also opined that the subject has a better reputation due to superior management associated with the business. While the condition of the property may be one factor, Van Santen contended that what is driving the occupancy at the subject property is the management of the business, the contract previously referred to, and the higher acuity patients. Van Santen also analyzed the rates and occupancies of competitive properties in the subject's marketplace; Van Santen found the weighted average stabilized occupancy rate of four nursing home competitors in Kane County was 76% (Report, p. 90). He also noted for three of those properties in Kane County, the private pay rates for private rooms ranged from $124 to $260 per day and the semi-private room rates were $120 or $130 per day (Report, P. 90). Meanwhile, the subject property for 2000 through 2002 reflected total revenue ranging from $118.94 to $138.05 per patient day. From this historical income data, he determined a stabilized revenue of $138.00 per patient day based on the actual gross income; with a stabilized occupancy rate of 95%, Van Santen projected potential yearly gross income of $9,905,261 (Report p. 91).

Next, expenses such as nursing, housekeeping and plant, dietary, employee welfare, laundry and linen, management fees, general and administrative, along with insurance were considered for projected total operating expenses of $8,247,206. To maintain the nursing home and thus maintain the room and board rates, periodically personal property must be replaced; part of the earnings must be directly attributable to the personal property.

Van Santen concluded based on personal property data from the cost approach the depreciated value of the personal property with an 11% rate of return over four years results in a deduction for return on and of personal property of $166,635 annually. Thus, the appraiser concluded a stabilized net income before deduction for real estate taxes of $1,491,419 (Report, p. 97).

The next step under the income approach analysis was arriving at an appropriate capitalization rate. Van Santen indicated that an overall rate from the market was the preferable method (Report, p. 100). Van Santen set forth net income data at the time of sale for five nursing home properties considered comparable to the subject. These five sales occurred from June 2001 to January 2002. None of the properties were located near Kane County; one was in far western Illinois (Carroll County); one in rural west/central Illinois (Greene County); and three in the metropolitan East St. Louis area. The properties had buildings ranging from 14 to 33 years of age and sale prices ranging from $1,899,368 to $7,888,057 or from $15,569 to $52,587 per bed, including land. At the time of sale and based upon published data, these properties had net operating incomes ranging from $202,894 to $999,834 or from $1,663 to $6,665 per bed. These sales and income figures resulted in overall capitalization rates ranging from 10.7% to 12.8%. The appraiser also used the band of investment technique arriving at a capitalization rate of 12%. As a further indicator, Van Santen considered published investment surveys of capitalization rates for nursing homes which ranged from 10% to 15.5%. Van Santen concluded an overall rate for the subject property of 13.0%. Then, through a series of calculations as reflected on page 104 of his report, Van Santen determined an adjusted effective tax rate of .8% was necessary. Capitalizing the subject's net income of $1,491,419 by the rate of 13.8% results in a market value of the total assets of the business by the income approach of $10,800,000, rounded.

In the next step under the income approach the appraiser sought to quantify how much of this "total assets of the business" value was represented by the business enterprise as opposed to the land and building. As stated on page 48 of his report, "business enterprise value is a term applied to the concept of the value contribution of the total intangible assets of a continuing business enterprise such as marketing and management skill, an assembled work force, working capital, trade names, franchises, patents, trademarks, contracts, leases, and operating agreements."

In addition to the foregoing items, Van Santen identified a certificate of need[2] as being an intangible asset of the property and the owner/operator even though it cannot be sold separately from the property in Illinois. The certificate of need enhances the market value of the total assets of the business; in the appraiser's opinion, the certificate of need is not part of the real estate, although he acknowledged that the facility cannot achieve its highest and best use as a nursing home without the certificate of need. Van Santen also made reference in his report to sales data for certificates of need in Ohio for facilities that ranged from 15 to 107 beds and sales prices ranging from $17,000 to $25,500 per bed (Report, p. 106). Van Santen also considered the discharge agreement(s) and level of patient acuity (level of care required), which he previously referenced in his testimony, as part of the subject's intangible assets which must be considered part of the business enterprise value.

At pages 51 through 57 of his report, Van Santen set forth the four methods he considered to deduct for business enterprise value: (1) comparison of the cost approach value to the income approach value, (2) the capital cost component for the Medicaid rate, (3) the Department of Housing and Urban Development loan underwriting guidelines, and (4) differential between real estate rent and going concern income. Then at pages 108 through 112 of his report, Van Santen set forth his analysis of each method with regard to the subject property.

Method four was found to be inapplicable as there were no arm's length leases involving the subject property. Van Santen also testified that very little weight was placed on the third method as it is an arbitrary number by the government assigned to all nursing homes across the country uniformly assuming the amount of business enterprise value is the same. His analysis of method three to the subject is set forth on pages 110-111 of his report and provides a range of business enterprise value under this method from $1,618,408 to $2,697,346. Van Santen testified that reliance was placed primarily on the first method and secondarily on the second method.

Under method one, the estimated market value of the total assets of business of $10,800,000 arrived at under the income approach is then reduced by the real estate component (value found in the cost approach) for an estimated business enterprise value. As set forth in summary on page 112 of the report, this first method

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[2] Pursuant to governmental regulation by the State of Illinois Health Facilities Planning Board, in order to control the number and cost of nursing homes, the government establishes criteria to determine the need for additional nursing beds and determines whether to issue a Certificate of Need upon application. (REAC report, p. 26)

arrived at a business enterprise value of $7,200,000, although there is an error here. As shown on page 108 of his report, Van Santen erroneously stated the value under the income approach was $10,900,000. In fact, method one results in a business enterprise value of $7,100,000.

As to the second method, Van Santen indicated that there are typically three components to the Medicaid rate: nursing and direct care; support services; and capital cost. In this second method, the appraiser isolates the real estate value by considering the capital cost component of the Medicaid reimbursement rate applicable to the particular state where the property is located. As to the subject property, 70% to 80% of the overall patient census has been Medicaid patients. For this appraisal, based on data from the Illinois Department of Public Aid, Van Santen sets forth that the 2003 capital cost component of the Medicaid daily reimbursement rate specific to the subject property was $12.79 or approximately 11.6% of the total daily rate (Report, p. 109); the remaining 88.4% of the daily rate consists of reimbursement for nursing care and support services. Van Santen also noted that he found the Medicaid rate paid to the subject is fairly average of the competitors.

Since the capital cost component is intended to provide a rate of return on the land and buildings, with additional amounts added for equipment, working capital interest costs, and real estate taxes, Van Santen adjusted the amount to remove equipment, working capital interest costs and real estate taxes. Based on the information he received from the Illinois Department of Public Aid, a total of $3.79 per patient day was deducted for these items leaving $9.00 per patient day for return on the land and buildings as reflected on page 109 of his report. At $9.00 per patient day for one year for all 207 beds and 95% occupancy, Van Santen found $645,995 as net income attributable to the real estate (TR. 86). To this figure, Van Santen estimated a 10% capitalization rate for the real estate component only which resulted in $6,460,000, rounded, for the real estate. Then, taking the total assets of the business value of $10,800,000 and this net income for the real estate only derived from the Medicaid reimbursement rate, Van Santen concluded a business enterprise value of $4,340,000 under the second method.

In reconciling methods one and two, Van Santen concluded an estimated business enterprise value of $6,500,000, rounded; as noted in the report, this figure is then to be deducted from the final values under both the income capitalization and sales comparison approaches to arrive at a value for the real estate only. Once the business enterprise value is deducted from the total assets of the business under the income capitalization approach, it results in an estimated value of the real estate only based on the income approach of $4,300,000.

Under the sales comparison approach, Van Santen examined sales of other nursing homes which include a great deal of tangible assets such as personal property, the land and building along with business enterprise value. Van Santen's report notes that adjustments for differences are necessary since no properties are identical and the sales data is presented simply as some of the transactions taken into consideration in arriving at an opinion of value, not as independent evidence of the value of the subject.

The appraiser considered five sales of nursing homes primarily in downstate Illinois (referenced previously with regard to the capitalization rate). These sales occurred between June 2001 and January 2002 for total sales prices ranging from $1,899,368 to $7,340,376; Sales 2, 3 and 4 are said to be part of a bulk sale transaction which had an aggregate unit price of $44,444 per bed, including land. The data further indicates the buildings ranged in age from 14 to 33 years old and ranged in size from 27,852 to 55,385 square feet of building area. The properties had from 119 to 150 beds in each facility. At the time of sale, the properties had occupancy rates ranging from 67.8% to 85% and payor mixes of Medicaid patients ranging from a low of 66.4% to a high of 94%. Van Santen summarized some of the data on these sales in a chart on page 127 of his report which reflects sale prices ranging from $15,569 to $52,587 per bed, including land. The appraiser made adjustments to the properties for differences in location, age, occupancy rate at time of sale, building size, and number of beds.

The report states that strongest consideration was "given to the net income per bed, since this unit of comparison inherently reflects all of the physical and economic characteristics of the nursing home operation." (Report, p. 126) In order to compare the net operating income per bed after taxes of the comparables to the net operating income per bed of the subject, Van Santen utilized conclusions drawn in the income capitalization approach to arrive at an estimate of the stabilized net income after estimated stabilized real estate taxes of the subject (Report, p. 115). Van Santen concluded that the stabilized net income after taxes of the subject property would be $6,706 per bed. On page 128, Van Santen summarized his calculations of net operating income per bed after taxes of the sales comparables which ranged from $1,663 to $6,665 per bed. With a net income per bed slightly higher than the comparables, Van Santen concluded that the subject has an estimated retrospective market value of the going concern of $53,000 per bed unit or $10,971,000 given that the comparable properties had sales prices ranging from $15,569 to $52,587 per bed. From this estimate of the market value of the total assets of the business based on the sales comparison approach must be deducted the business enterprise value of

$6,500,000 and the depreciated value of the personal property of $517,500 to arrive at a value of the real estate only of $3,953,500. Thus, under the sales comparison approach Van Santen arrived at an opinion of value of the real estate only of $4,000,000, rounded, as reflected on page 128 of his report.

In reconciling the three approaches to value, Van Santen noted in his report that he placed most weight on the cost approach since it did not necessitate adjustments for the going concern value (Report, p. 130), but later indicated that most emphasis was "placed on the value estimates obtained in the Income Capitalization Approach and Cost Approach." (Report, p. 132) From the data set forth in the report, Van Santen concluded that the retrospective market value of the real estate portion of the total subject property as of January 1, 2003 was $4,000,000.

On cross-examination, the appraiser acknowledged examining financial statements (accounting-type statements), plat of survey, property tax bill, and floor plans of the subject property along with information from the Illinois Department of Public Aid with regard to Medicaid rates and the various component parts. Typically Van Santen also requests records of recent capital improvements from the owner, but did not mention that as one of the documents he reviewed; he testified that his report accurately reflected the condition of the subject property. With regard to his inspection of the property on June 18, 2004, Van Santen testified that the "administrator" at the time walked him through the facility, but he could not recall a name. (TR. 60)

In questioning by intervenor's counsel, Van Santen acknowledged that the subject property's 2003 97% occupancy rate exceeds the industry standard in that it is higher than the majority of the competitors.

With regard to his effective age determination, Van Santen indicated on cross that in the hundred or so nursing home appraisals he has performed in the last few years, he has not always found the actual age to be the effective age of the property; however, Van Santen reiterated that the subject property reflects its relative age. Furthermore, Van Santen acknowledged that his appraisal reflected no capital improvements to the subject in the five year period of time prior to the effective date of the appraisal. However, Van Santen admitted that he was not hired to express an opinion on the value of the subject property as of January 1, 2004, the lien date at issue in this proceeding.

When considering the other nursing homes in Kane County listed on page 29 of his report, Van Santen acknowledged that the subject was the "biggest"[3] nursing home in the county.

With regard to entrepreneurial profit, Van Santen clarified that direct costs would typically be referred to as "hard costs" whereas indirect costs would be things like interest or other incidental costs associated with carrying the property while it is under construction. The cost of obtaining appropriate zoning for a nursing home would be attributable to the land value. Upon questioning by intervenor's counsel, Van Santen characterized a certificate of need as an intangible asset which is assigned to both the parcel of land and the particular owner/operator despite the fact that it cannot be sold separately in Illinois; Van Santen reiterated that the certificate of need is not an "indirect cost" associated with the property. Furthermore, Van Santen acknowledged that the subject cannot achieve its highest and best use as a licensed nursing home without the certificate of need.

When questioned about leases involving the subject property, the appraiser noted that there were no "arm's length" leases involving the subject property; although there was a lease to a related company.

With regard to the historical operating statement of the subject property (Report, p. 88), Van Santen acknowledged that for years 2001 and 2002, the subject property experienced an increase of total revenue per patient day from the prior year of 13.4% and 13.3%, respectively.

As explained in cross-examination for one portion of his business enterprise value determination, Van Santen utilized information provided by the Illinois Department of Public Aid as to the amounts to be deducted for moveable equipment, working capital interest costs of a short-term debt nature and real estate taxes resulting in a net of $9.00 per patient day for return on the land and buildings. Van Santen acknowledged that he calculated this return based on 100% Medicaid occupancy with a 10% real estate capitalization rate and therefore arrived at an estimated real property value of $6,460,000, even though the facility had only about 70% Medicaid occupancy. Van Santen agreed with intervenor's counsel that the foregoing calculation was akin to a rate-based approach to value, but he would not agree with counsel that $6,460,000 was Van Santen's opinion of value of the real property nor the value as determined by the Illinois Department of Public Aid (TR. 102-03). Van Santen did agree this figure was

[3] Although "biggest" was not defined, it presumably refers to the number of beds. Although, it is noted that three of the other 21 Kane County long-term care nursing home facilities also have in excess of 200 beds per facility.

one indication of the value of the real property. However, in subsequent testimony on cross-examination, Van Santen agreed with counsel that "for purposes of the State [IDPA], [the value is]" $6,460,000 (TR. 110-111).

Regarding the reconciliation of his methods of determining business enterprise value finding a conclusion of $6.5 million, Van Santen testified that he placed most weight on method one which found a $7.1 million value, with some consideration given to method two which found a $4,340,000 value (TR. 105). The appraiser acknowledged that he relied primarily on method one which is driven by the appraiser's determination of effective age and depreciation and that method two is determined largely from objective data from the Illinois Department of Public Aid, except for Van Santen's 10% real estate capitalization rate. The average of the two methods used would be $5,770,000 which is about $730,000 less than Van Santen's estimated business enterprise value.

Van Santen also acknowledged that if he had selected a younger effective age for the subject property, the depreciation figure would be reduced and the replacement cost new less depreciation would be a higher figure. He also admitted that such adjustments would bring the total figure closer to $6,460,000.

With regard to the selected sales under the sales comparison approach, the appraiser acknowledged that none of the sales were in the "Chicagoland" area and that all of the sales were substantially from downstate Illinois.

Finally, while Van Santen arrived at a value conclusion for the subject property of $4,000,000, counsel for intervenor pointed out that based on Van Santen's appraisal report the "State" (IDPA) value was $6,460,000 and the estimated fair market value based on the 2004 assessment was $5,473,000.

On redirect examination, the appraiser indicated that he was aware of a situation within the past three years in downstate Illinois where a nursing home (along with its certificate of need) was purchased by another nursing home in the same service area; the purchased nursing home was closed and the certificate of need was transferred through a process with the State of Illinois to the buyer's existing facility.

The appellant's second witness was Kim Kohls, Administrator of Countryside Healthcare Center. As Administrator, Kohls is responsible for total operational management of the facility. She testified that having worked for this facility for seven years and as a nursing home administrator for a total of 23 years, in each facility she has been associated with she has increased the census to a very high occupancy rate by focusing on the niches in the community where the needs exist. For this facility, one factor in the niche market is a referral contract for discharged patients providing only two choices for referral including the subject property. In addition, the facility is the only one in the area to accept "Public Aid pending" patients where the facility works with the patient through the approval process.

Based on the estimated fair market value of $4,000,000 and applying the 33.33 percent level of assessment, the appellant felt that a total assessment of $1,333,200 was supported for the subject property. The inference was that the appraiser's market value estimate would be the same as of January 1, 2004, the date of valuation in this appeal, although Van Santen was never asked for an opinion as of that date.

The board of review submitted its "Board of Review Notes on Appeal" as required by the Property Tax Appeal Board wherein the final assessment of $1,824,278 of the subject property was disclosed. The final assessment reflects an estimated market value of $5,479,958 or $26,473 per bed using the 2004 three-year median level of assessments for Kane County of 33.29% as determined by the Illinois Department of Revenue.

In support of the assessment of the subject property, the board of review submitted a property record card of the subject and a grid analysis with minimal descriptive data entitled "Nursing Homes." As stated by the board of review member at hearing, the grid was prepared by the assessor to show uniformity at the time of the local appeal hearing.

To summarize, for seven either retirement home or nursing home properties in the area, the grid stated the parcel identification number, address, number of stories, number of beds, land size, building size, land assessment, improvement assessment, and total assessment for each property. By presenting equity comparables, the board of review failed to address the appellant's market value evidence with this aspect of its grid.

In addition, this same grid contained sales price data for six of these properties in the area. Facilities with sales data ranged in size from 16,118 to 159,966 square feet of building area and from 68 to 244 beds or units. These sales occurred between July 1996 and October 2003 for total sales prices ranging from $100,000 to $13,516,615 or from $671 to $58,261 per bed or unit, including land. Only two sales which occurred in September and October 2003 for sale prices of $671 and $6,618 per bed or unit including land, respectively, were recent enough for consideration for a 2004 assessment appeal based on overvaluation. Furthermore, the subject's estimated market value based on its final assessment of $5,479,958 or $26,473 per bed, including land, falls far above the range established by these most recent suggested sales comparables presented by the board of review in this grid analysis.

For purposes of this appeal pending before the Property Tax Appeal Board, the board of review relied upon the appraisal presented by the intervenor and allowed intervenor's counsel to take the lead at the hearing.

The intervenor appeared before the Property Tax Appeal Board through counsel with an appraisal which estimated a fair market value of the subject property as of January 1, 2004 of $6,200,000, and also presented supporting testimony by the appraiser at the hearing.

The intervenor's only witness was Nicholas F. Solano, an appraiser since 1982 currently with Integra Realty Resources who prepared the appraisal report. The report on its face indicates it was prepared for both the Chairman of the Kane County Board of Review for *ad valorem* tax assessment purposes and the Whitt Law office as counsel for the City of Aurora (Report, p. 4).

Solano testified that he has been a member of the Appraisal Institute with an MAI designation since 1990 and also has been a licensed State Certified General real estate appraiser since 1992. He further testified that he has experience in valuation of specialized real estate properties such as nursing homes, hotels, and other properties related to business interests like bowling alleys and car washes. Solano's prior experience specifically with nursing home valuations from the early 1990's to 2005 has involved five prior appraisal projects in Alsip, Elgin, Rolling Meadows and Lansing, one of which was for condemnation purposes and the others of which were for tax appeal and financing purposes. The witness was tendered as an expert without objection.

The appraiser testified that he inspected the subject property in March 2006 by walking through the common areas, some of the private rooms, common shower facilities, cafeteria, and other areas finding it to be a well maintained property in good condition. On this inspection, the appraiser was accompanied by a maintenance man of the facility and an assistant manager. The appraiser testified that he specifically inquired about the age of the roof and was informed that it typically was replaced in phases; of the four wings of the building, one-half had been done "a few years earlier" and the other half needed to be scheduled in the future. In developing his complete appraisal in a self-contained report of the subject, Solano considered the three traditional approaches to value.

Under the cost approach to value, the appraiser first analyzed the land value as if vacant. Solano selected five land sales from Naperville, Schaumburg, Elk Grove Village, St. Charles and Aurora; four of the sales were for assisted living or nursing home use and the property in Aurora was for residential use. The sales occurred from January 2000 to January 2003 with the land ranging in size from 139,392 to 341,946 square feet. The sale prices ranged from $700,000 to $1,700,000 or from $4.80 to $8.50 per square foot of land area. The appraiser considered adjustments for a number of factors including time, location, size and zoning which resulted in adjusted sale prices of $5.37 to $8.80 per square foot or an average of $6.61 per square foot. Solano opined that the applicable unit value of the subject was $7.00 per square foot of land area for an indicated land value of $915,000, rounded.

In order to estimate the replacement cost new of the improvements, Solano utilized the Marshall-Swift Cost Valuation Service with an average quality rating and masonry construction with adjustments for time, location, sprinklers, and an elevator to arrive at a final base cost with some of the indirect costs included. The appraiser added an allowance of 5% for additional indirect costs not accounted for by the valuation service such as taxes and carrying costs on land during construction, legal and accounting fees, and others.

Solano also added a final component of entrepreneurial incentive of 15% of the total direct and indirect costs as profit to the real estate. Solano testified that entrepreneurial profit is a profit a developer would expect to earn on construction of a building such as the subject which is over and above replacement cost; it is a common market based profit margin. In the report, it states entrepreneurial incentive "is the economic reward that would be necessary to motivate a developer to undertake the real estate project." Solano testified that it is common to add the factor of entrepreneurial profit in the replacement cost.

Solano testified the total replacement cost estimate was for the cost to construct new as of January 1, 2003, not 2004. Solano arrived at an adjusted base cost of $113.05 per square foot for a convalescent hospital of 60,275 square feet of building area or a total of $6,814,068.[4] To the base replacement cost of the building, the appraiser added his indirect costs of 5% ($340,703) and his entrepreneurial profit of 15% ($1,022,110) to arrive at a total estimated replacement cost new of the building of $8,176,882. Solano then opined the value of site improvements of the parking lot and landscaping to be $248,000. To the site improvements, Solano again added his indirect costs of 5%

[4] In actuality, $113.05 multiplied by 60,275 square feet of building area equals $6,814,089.

($12,400) and his entrepreneurial profit of 15% ($37,200) to arrive at a total estimated replacement cost new of the site improvements of $297,600. Thus, Solano opined the total replacement cost new of the improvements, inclusive of direct and indirect costs along with entrepreneurial incentive, was estimated to be $8,474,482.

To arrive at depreciation, according to Solano's testimony an adjustment must be made for the age of the facility and the utility of the facility; in other words, how the market would view the property in its pricing. Solano utilized a modified age-life method of depreciation being a ratio of effective age which he estimated to be 18 years and economic life which he estimated to be 50 years.

Solano justified his effective age estimate testifying that from his observation the subject had an estimated remaining life of 32 years before it must undergo a major rehabilitation or be completely redeveloped in order to be economically viable. Solano further testified that he arrived at his effective age based on how the property would be priced on the market based not only on its physical condition which is good, but also on the economics of the market and the supply and demand for facilities like this in the market. According to Solano, actual age and effective age are usually only the same when the property is in less than average condition and demand is not what it was before; in the Chicago area, it is common for effective age to be less than chronological age because properties are continuously maintained and updated along with demand factors and economic factors which justify an effective age of less than chronological age.

Based on his belief that there is a good demand for nursing homes, the effective age of the subject would therefore be less than the chronological or actual age of the property. Thus, Solano estimated accrued depreciation of 36% for the building of $2,943,677; a higher depreciation of 40% was estimated for the site improvements resulting in depreciation of $119,040. To further support this calculation, Solano noted that with $3 million of depreciation in the cost approach, this works out to about $50 per square foot which falls within the range the appraiser is familiar with for restoring residential properties such as apartments to condominiums to almost new condition. No further deduction for functional or external obsolescence was justified according to Solano. In summary, Solano found the depreciated replacement cost of the subject including site improvements was $5,411,764. After adding the land value, the appraiser arrived at an estimated market value of the subject property under the cost approach of $6,330,000 rounded.

Next, Solano's report examined the sales comparison approach. In analyzing five comparable sales obtained from the Chicago area, the appraiser utilized the price per bed as the appropriate unit of comparison.[5] One bulk portfolio sale (Sale #1) occurring in January 2003 involved five separate properties with a total of 574 beds located in Cook and DuPage Counties where the buildings, which opened between 1967 and 1996, ranged in size from 14,364 to 74,419 square feet on parcels ranging from 1.81 to 3.62 acres of land and sold for a total of $20,496,666. Averaging the total sales price over the number of beds, the report summarizes the sale as being for $35,708 per bed, including land. The appraisal report also acknowledges the occupancies of these five properties comprising Sale #1 ranged from 71% to 89% with 82% being the overall average set forth in a summary chart on page 58 of Solano's report. In addition, Solano reported the effective gross income of these properties as $19,130,220 with private pay occupancy of 30% at the time of sale and an average Medicaid reimbursement rate of $91.75 per patient day.

Sales data for the four remaining Cook County sales occurred from December 2001 to November 2003 with structures which were built from 1965 to 1988. These buildings ranged in size from 43,800 to 95,000 square feet of building area and had from 146 to 259 beds at each facility.[6] The land area of these properties ranged from .87 to 10.330 acres. Occupancy rates of Sales #2 through #5 ranged from 67% to 93%. These four sales comparables ranged in sale price from $6,300,000 to $9,000,000 or from $27,600 to $60,000 per bed, including land. In his report, Solano also reported effective gross incomes for Sales #2 through #5 ranging from $3,741,200 to $5,174,729; it is noted that Sales #2 and #5 represent the low and high end of the range of effective gross incomes, respectively, and Solano reported that he "estimated" these particular properties' effective gross incomes. Solano did not specify how he made those estimated calculations for Sales #2 and #5. Solano additionally reported Sales #2 through #5 had private pay occupancy rates of from 1% to 31% and Medicaid reimbursement amounts ranging from $73.20 to $102.86 per patient day. Solano reported the subject property as of January 2004 as having 97% occupancy of which 27% was private pay and a Medicaid reimbursement rate of $103.76 per patient day.

To these sales, the appraiser made adjustments for time-market conditions, location, age, size and economic factors. Solano adjusted the sales for different economic characteristics such as occupancy, payor mix and Medicaid rates (Report, p. 60). The

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[5] On page 47 of the appraisal report, it was stated that "price per room" was selected for comparison.

[6] Sale #3, while listed as having 246 beds, was noted as broken down into 163 skilled care licensed beds and 86 intermediate care licensed beds. No other comparable was defined in this manner.

report summarily states "[t]he other sales have similar effective ages compared to the subject property." (Report, p. 60) Based on economic characteristics, Solano found the subject property to be superior to all of the sales comparables. In summarizing his value indication based upon the sales comparable approach, Solano made two erroneous statements concerning the range of sale price value indications from "$27,267" to $60,000 "per room" prior to adjustment (Report, p. 60). As depicted on his chart on page 58, the range is actually $27,600 to $60,000 per bed.

After adjusting for time on four of the sales, Solano combined his percentage adjustments for location, size, condition and age, and economic factors. In total for the five properties these latter adjustments ranged from -20% to +60% and resulted in a range of $45,974 to $55,557 per bed, although the report mistakenly classifies the data as price "per room." After these upward and downward percentage adjustments made to the sales comparables on a price per bed basis as set forth in the chart on page 61 of the report, Solano arrived at an average adjusted price per bed of $49,459, again mistakenly stated as price "per room" (Report, p. 61).

Considering this data, Solano chose a sale price "per bed" of $50,000 or $10,350,000 for the subject property. "This [value] is toward the low end of the indicated range of the comparable sales because the subject is already running at near full capacity, and has minor upside potential under the current operation." (Report, p. 61) For further reference, Solano noted that the subject had a stabilized effective income estimate under his income approach of $9,703,860 or an effective gross income multiplier of 1.07. Solano summarized that the comparable sales had effective gross income multipliers ranging from 1.07 to 1.74 based on estimated income at the time of sale. Thus, Solano found this analysis supported his price "per room" conclusion.

Solano's estimate of $10,350,000 for the subject property based on the sales comparison approach was a market value of the real estate, personal property and the intangible business value or going concern value. On page 62 of his report, Solano deducted both the contributory value of personal property of $1,020,000 and the contributory value of business interests of $3,000,000 which were calculated in his income approach. Having extracted those items of personal property and business interest, the appraisal report arrived at an estimated market value of the real estate only under the sales comparison approach of $6,330,000.

Next, Solano testified that there are generally two accepted techniques to apply the income capitalization approach: direct capitalization and yield capitalization (discounted cash flow analysis). Under yield capitalization, the appraiser spreads the income over a holding period of, for instance, ten years and then discounts that back to a present value estimate. In other words, it is a time series analysis. In comparison, direct capitalization takes a single year's income and capitalizes that into a value estimate. Solano felt the direct capitalization approach was the most appropriate method for the subject nursing home property.

To begin his analysis, Solano examined the prior years' history of the facility from 2000 through 2003 in terms of income from financial statements, a rate sheet for the subject property, expenses and net income as presented in the subject's financial statements which had been provided. To begin the income analysis as shown on page 64, Solano noted that income derived from non-private residents is set by the Illinois Department of Health [*sic*].[7] Moreover, Solano reported the subject property consists of 131 licensed skilled nursing care beds and 76 licensed intermediate care beds. While Solano noted that Medicaid rates are specific to each facility and for 2003 the subject's base Medicaid rate was $103.76 per patient day, his report further noted that the Medicaid rate was not usually a point of valid comparison in the valuation process although private pay rates were a matter of comparative analysis.

Solano found that 27% of the occupancy of the subject for 2003 was private pay of an average of $174.36 per day. Meanwhile, 73% of occupancy was controlled by rates established by the Illinois Department of Public Health [*sic*] and "the subject property is dependent on rates established by the Department." In order to gather market data, Solano reported that a survey was done of private pay rates for other nursing homes in the subject market area; the survey results for five facilities with from 68 to 185 beds are set forth in a table on page 65 of the report. Only four properties reported private pay daily rates ranging from $130 to $184 for single and from $100 to $166 for double occupancy rooms as of December 31, 2003 and these facilities range from 6% to 73% private pay residents. From these four surveyed properties, Solano concluded a market average of $161 per day for a single and $134 per day for a double room. Solano noted that the subject's private pay rates were toward the higher end of the market average at $195 per day for a single room and $160 per day for a double room. The report also notes that private pay rates are a function of the age/quality of the facility, its location, services provided, management/reputation and cost of operations. From the foregoing data, Solano concluded that the subject's rate of occupancy and private pay rates were reasonable at market levels (Report, p. 66).

[7] The Illinois Department of Public Health licenses and inspects nursing home facilities for health compliance issues. The Illinois Department of Public Aid establishes Medicaid reimbursement rates in Illinois.

Solano then analyzed the potential gross income of the subject property based on its 2003 Medicaid reimbursement rate which was now stated to be $103.53 per day and which was noted to be increased to $111.08 per day for 2006. Besides the private pay income for approximately 55 beds earning an average of $174.36 per day, additional income in addition to Medicaid/Medicare reimbursements is also generated for supplies and extra therapy services. Gross revenue from private and public-pay residents between 2000 and 2003 ranged from $121.36 to $136.34 per occupied bed per day. Utilizing an average revenue rate of $136.50 per bed per day, Solano estimated the gross potential stabilized income of the subject at $10,003,860 which includes a vacancy allowance of 3% for the subject.

Solano further noted that based on market data as set forth on page 65 of his report, the five market area properties reported occupancy rates of from 57% to 93% or an average in the Aurora market of 81% whereas the subject from 2000 to 2003 maintained occupancy of from 86.2% to 97.1% or an average of 92% with an upward trend since 2000. Solano attributed the subject's high occupancy rate to its physical plant, condition of the property, and the management/expertise along with the reputation of the facility as well. Solano viewed the management of the subject as being above average, but clarified that he appraised it as a nursing home with 24-hour skilled nursing care without doing an in depth management study of the facility for a valuation of the nursing home business with the real estate combined; the instant appraisal was not a business analysis.

In his report, Solano then refined the income estimate of $10,003,860 to account for bad debts, interest income and Medicaid/Medicare reimbursement adjustments. Based on the historic data of the facility, he determined the stabilized bad debt adjustment was rounded down to be an estimated -$360,000 and the other income sources were rounded down to add an estimated $60,000 for valuation purposes. Thus, the appraiser estimated total effective gross income to be $9,703,860 for valuation purposes.

Based upon the historic financial data of the subject from 2000 to 2003, the operating expenses (before real estate taxes) were found to be from $41,889 to $45,231 per occupied room or from 87% to 102% of effective gross income; expenses ranged from $114 to $124 per patient day between 2000 and 2003. The actual expenses included management fees for the subject of from 8% to 8.63% of effective income; given industry averages, the appraiser found a 5% management fee to be more reasonable and that figure was used in the stabilized estimate for valuation purposes. Additionally, expenses did not include a replacement reserve, so based on the age and condition of the subject facility the appraiser estimated a reserve account of $500 per bed or rounded to $100,000. Thus, based on the foregoing, the appraiser on page 68 summarized stabilized expenses (including reserves but excluding taxes) to be $41,119 per occupied "room" although the narrative on page 68 references this as expenses per "bed." Solano in his chart sets forth the expenses to be $113 "per patient day" and 85.17% of effective gross income. The chart on page 69 of the report reflects total estimated stabilized operating expenses before adjustment of $8,265,000. From this foregoing data, Solano was able to estimate a stabilized net operating income of $1,438,860 annually before deduction of real estate taxes.

Solano then determined a capitalization rate by utilizing investor surveys as well as capitalization rates extracted from his comparable sales data. Using study data, average capitalization rates for nursing homes ranged from 10% to 16% with an average of 13% for 2003; the appraiser's report noted that rates have moved upward over the past two years (Report, p. 70). Next, from examining his comparable sales data, Solano noted that the capitalization rate for the bulk sale property of 16.80% would not be as meaningful as the other calculations; the sales showed capitalization rates ranging from 5.94% to 16.80% with an average of 10.21%. The income for Sale #5 was noted as estimated and resulted in an estimated capitalization rate of 11.50%; the remaining three sales comparables presented capitalization rates of 5.94% to 9.12%. The report further noted these were composite capitalization rates, unloaded for taxes, and were applicable to the real estate, personal property and any business interest inherent in the sale price. Using the information gathered from these two sources, Solano developed an overall unloaded capitalization rate for the subject which is a blended rate for not only the real estate, but also the personal property and the intangible business interests, of 13%.

At this point, Solano then loads the capitalization rate to reflect the tax rate relative to the value of the property by using the 2004 tax levy, the assessment ratio and an estimate of what the real estate would contribute to the overall pricing of the property. Through this analysis, Solano arrived at the figure of 1.44% as shown on page 71 of the appraisal report. Utilizing this data of a tax-loaded capitalization rate of 14.44% and net operating income of $1,438,860, the appraiser arrived at an estimated value of the realty, personal property and the business under the income approach utilizing direct capitalization of $10,000,000, rounded.

Components of the nursing home were the real estate (land and building), personal property (fixtures, furniture, and kitchen equipment), intangibles such as the business, expertise in management, the going concern, and the good will which were valued as part of the business valuation. Thereafter, to arrive at a value for *ad valorem* tax purposes, Solano first had to account for the personal property (beds, furniture, televisions, office furniture, etc.) and the equipment. The report states Marshall's data places a replacement cost new estimate of $8,500 per bed or approximately $1,760,000 for the subject property. Based on a 42% depreciated cost basis with an effective age of 5 years and economic life of 12 years, the appraiser arrived at an estimate of value contributing to the overall property of $1,020,000.[8]

Next, Solano had to account for the value attributable to the business (intangible business interests) which he arrived at by beginning with an examination of the Housing and Urban Development (HUD) guidelines. Those guidelines for financing the development of nursing homes hold that a maximum of 25% of income is allocated to business interests. Solano acknowledged that superior management or better management is more of a business interest for nursing homes than a real estate interest. The report on page 73 further notes that good will stemming from reputation can be a significant part of the business interest for a nursing home. As to the subject's occupancy rate of 97%, Solano testified it was both a real estate interest and a business interest.

Utilizing the HUD percentage, Solano arrived at $360,000 as an allocation to business interests in net income and yet the subject's financial statements reflected a much higher figure. As noted by Solano, deducting all expenses to operate the property, including rent paid through partnerships, the facility was still generating a great deal more income than $360,000. For instance, Solano testified that in the prior year there was almost $900,000 in income and the year prior to that it was about $700,000. Because the HUD guidelines did not accurately reflect the subject's historical income, Solano simply estimated 50% of the total net income for business profit in this case or approximately $720,000.

To the total net income for business profit of $720,000, Solano then applied a capitalization rate of 25% which rate had to be higher than the blended rate of 13% used for the overall property; also he extracted capitalization rates from his comparable sales for the business interests utilizing two sales in particular which had capitalization rates of 30% or 35% according to his testimony. In his report, Solano specified he utilized bulk Sale #1 and Sale #5 which he analyzed to find capitalization rates allocated to the intangible business interests of approximately 37% and 30%, respectively (see page 73). Applying the chosen 25% rate resulted in a business value

[8] Deducting 42% depreciation from the total replacement cost new of the personal property results in a depreciated value of personal property of $1,020,800.

of $2,900,000. Deducting this business value of $2,900,000 and the personal property value of $1,020,000 resulted in an estimated value of $6.1 million rounded to the real estate only based upon the income approach.

Reconciliation of the appraiser's three value conclusions led him to arrive at a final value conclusion of $6.2 million. In further explaining his method of reconciliation, Solano testified that the cost approach was meaningful in this report because it is a pure real estate-based analysis whereas with the sales comparison and income approaches the real estate figures were residual figures; the range was tight among the approaches and Solano "chose the middle."

When questioned on cross-examination about his effective age determination, Solano reiterated that it is based not only on physical condition, but also the economics of the market in terms of supply and demand for facilities like this; the subject happens to be in good demand, the facility is meeting the needs of the market, it has high occupancy, and has good earning potential along with a history of good earnings which all played into estimating the effective age. The facility's occupancy relates to how it is meeting the needs of the market and its economic potential. The above average occupancy is due to the physical plant, the condition of the property, the above average management, the expertise and reputation of the facility. The intangible business interests that were valued together included good will, expertise in management, and all those interests that go into the business or the going concern. Solano characterized the 97% occupancy rate as both a real estate interest and a business interest; Solano was unable to assess how much of the occupancy was attributable to each interest other than saying "enough to support $6.1 million in real estate." (TR. 240) Solano admitted that factoring in above average management to arrive at an effective age is a judgment call, although he drew upon the comparable sales data in estimating their depreciation factors, each of which had effective ages less than their actual ages; in addition, remaining life also played into the estimate as well.

According to Solano, the actual age and effective age of a property would tend to be the same in those instances when the property is in less than average condition and the demand is not what it had been previously. On the other hand, commonly in the Chicago area, effective age is less than chronological age where the properties are continuously maintained and updated along with demand and economic factors which justify a lower effective age than actual age of the property.

He further noted that his use of an effective age of 18 years for the subject with a 32 year remaining life (before a complete redevelopment or rehabilitation would be necessary) resulted in depreciation of approximately $3 million under the cost approach or about $50 per square foot of building area. Solano noted that such a cost for restoration falls within the range of costs of between $30 and $60 per square foot which he has seen in condominium conversions of older apartment complexes.

Solano acknowledged that he did not inspect, had no information as to the actual ages or building square footages of any of the five market comparables he identified on page 65 of his report. Despite not having inspected these other market properties, Solano concluded from his inspection of the subject that it was maintained and in good condition. Also in discussing this survey data, Solano noted that his attempt at a phone survey, posing as an old person, was not successful and he had to resort to the Internet for data as published "through the State of Illinois website" effective as of December 31, 2003. (TR. 232-34)

While Solano defined entrepreneurial profit as a profit margin for the development over cost, Solano admitted that he was not aware of any specific instances where a nursing home was built and then resold for profit. Regardless, according to Solano, entrepreneurial profits apply to all real estate but the factors would change according to the category of real estate typically ranging from 10% to 20%, but a recent strip center the appraiser was familiar with had profited over 30%. Whether the property is built for use or built for resale, the reason to build it is for a profit incentive and that profit incentive must be accounted for somewhere according to Solano (TR. 242). Furthermore, Solano contends that there is profit both in the operation of the nursing home and in the construction of the real estate; the real estate has to earn income first and any residual income after the real estate goes towards the intangibles and personal property. The real estate portion of the going concern is the biggest portion of the investment and must earn a profit first before all the intangibles earn a profit and that is why the capitalization rate for the going concern is much higher than the real estate.

Under cross-examination it was established that eight parcel identification numbers were part of a bulk sale utilized in his report as Sale #1. With regard to this bulk sale, the appraiser admitted that individual allocations of sales prices may not be meaningful data, but what he found to be meaningful was the total portfolio price and from there he developed prices in terms of price per room, gross income multiplier and capitalization rate. With regard to this sale, Solano used the CoStar data service to gather the information reflected in his report and verified the data with an Integra appraiser who was a participant in the transaction.

Solano acknowledged that Sales #2 and #3 were properties located in Cook County and Sale #5 located in Barrington was considered a better location than the subject's location in Aurora.

To arrive at the non-realty components of the subject property in the income approach, Solano examined the prior year's actual earnings as a guideline along with the HUD guideline. Basically, since the financial statements reflected a lot higher earnings from the actual income, he came to a 50% figure since he was valuing the intangible business interests (business profit, interest on working capital and income for intangibles). In appraisals Solano performed for two other nursing homes, he did not utilize the HUD guideline.

Solano acknowledged that the sale of a nursing home generally involves the real estate, fixtures, and going concern/business interests. While Solano has spoken to participants in other business related real estate transactions, he has never spoken to participants in a nursing home purchase to ascertain whether they allocated the sales price between real estate, personal property and/or business interests.

In closing argument, intervenor contended the subject property had an estimated fair market value of $6,460,000, a figure which is not reflected in the value conclusions prepared by its appraisal expert, but rather was derived from applying direct capitalization at 10% to the appellant's appraiser's net income attributable to land and buildings based on the Medicaid rate as reflected on page 109 of his report. Based on that figure as an estimated fair market value and applying the 33.33 percent level of assessment, this would result in an increase in the total assessment of the subject property with a new assessment sought by the intervenor of $2,153,118.

Appellant submitted documentation (Appellant's Exs. 1A, 1B & 1C) to show that the Kane County Board of Review has reduced the 2004 assessed values of three comparable nursing home properties which the board itemized in its assessor's grid sales analysis. Upon objection to the submission by the other parties, appellant made an offer of proof as follows. Appellant argues the board of review's analysis can be used either to support uniformity or to support the sale represented in the document. Citing to 400 Condo Assoc v. Thomas Tully, 398 N.E.2d 951 and Hoyne Savings and Loan Assoc v. Hare, 322 N.E.2d 833 (judicial notice of subsequent reductions).

In response, intervenor contends the appeal herein is based solely on a recent appraisal; no rebuttal evidence of this nature was filed when it could have been and thus should be barred at this time; also based on the Administrator's testimony, two of the three suggested properties are not "comparable" to the subject property. The board of review also opposed the submission noting that parties stipulate for varying reasons and such stipulations should not be utilized as a basis for deciding the correct assessed value of the subject property.

For its reply, appellant noted the 2004 reductions occurred either within the past few days or a couple of months ago where appellant's counsel represents the involved nursing homes.

The Property Tax Appeal Board hereby sustains the objections made by intervenor and the board of review to Appellant's Exhibit 1A. This exhibit is a grid depicting the assessments for years 2004, 2005 and 2006 for three of the seven equity comparables set forth in the board of review's grid analysis. To the extent that appellant submitted this document to establish "corrections" to the board of review's grid for 2004 equity comparable assessments, said data should have been presented during the appellant's period for submission of rebuttal evidence which concluded on or about August 5, 2006.[9] More importantly, however, equity comparables, whether presented by the board of review or by the appellant, are irrelevant in this proceeding as they fail to address the appellant's overvaluation claim made in this proceeding.

The objections are also sustained as to submission of Appellant's Exhibit 1B as rebuttal evidence. This exhibit consists of four sets of property record cards for the subject and the three properties set forth in Appellant's Exhibit 1A. These documents on their face appear to confirm the 2004 assessment valuations set out in the board of review's grid analysis. As such, Exhibit 1B is not appropriate rebuttal.

Appellant's Exhibit 1C consists of three one-page documents on three different parcels; page one is a copy of a stipulation in Docket No. 04-00987.001-C-3 concerning a property on the board of review's grid analysis which reflects a reduction in the 2004 assessment, page two is a 2006 decision on another comparable in the board of review's grid analysis, and page three is a 2006 board of review decision in a third comparable set forth in the board of review's grid analysis. Again, pages two and three of the proposed Exhibit 1C concern an inequity argument which has not been made in this appeal and furthermore, concern 2006 assessments which are not relevant to this appeal and therefore,

[9] By letter dated July 6, 2006 from the Property Tax Appeal Board, appellant was granted a 30-day period for submission of rebuttal evidence in accordance with the Official Rules of the Property Tax Appeal Board (86 Ill. Admin. Code, Sec. 1910.66). By letter dated August 3, 2006 from the appellant's counsel directed to the Board, appellant specifically advised that "it has been determined that the evidence previously submitted on behalf of the appellant completes the filing of evidence." (Letter of Attorney Richards to the Board).

the Board sustains the objections to pages two and three of Appellant's Exhibit 1C.

The Property Tax Appeal Board hereby specifically overrules the parties' objections to the admissibility of page one of Appellant's Exhibit 1C, a stipulation in a case before the Property Tax Appeal Board concerning a 2004 assessment of a nursing home property in Kane County. Section 1910.90(i) of the Official Rules of the Property Tax Appeal Board provides:

> The Property Tax Appeal Board may take official notice of decisions it has rendered, matters within its specialized knowledge and expertise, and all matters of which the Circuit Courts of this State may take judicial notice. (86 Ill. Admin. Code, Sec. 1910.90(i)).

Having taken official notice of this stipulation and Board decision in Docket No. 04-00987.001-C-3, however, does not necessitate deciding the instant overvaluation appeal based on that stipulated assessment. Appellant did not make an inequity claim in this appeal and cannot be allowed to do so in the guise of rebuttal evidence at hearing.

After hearing the testimony and considering the evidence submitted by the parties, the Property Tax Appeal Board finds that it has jurisdiction over the parties and the subject matter of this appeal. The issue before the Property Tax Appeal Board is the determination of the subject's market value for *ad valorem* tax purposes.

The appellant contends the market value of the subject property is not accurately reflected in its assessed valuation. When market value is the basis of the appeal, the value of the property must be proven by a preponderance of the evidence. <u>National City Bank of Michigan/Illinois v. Illinois Property Tax Appeal Board</u>, 331 Ill. App. 3d 1038 (3rd Dist. 2002); *Official Rules of the Property Tax Appeal Board*, 86 Ill. Admin. Code Sec. 1910.63(e).

Having considered the evidence presented, the Property Tax Appeal Board concludes that an increase in the assessed valuation of the subject property is justified. The subject property has an assessment reflecting an estimated fair market value of $5,479,958 or $26,473 per bed using the 2004 three-year median level of assessments for Kane County of 33.29%. As will be set forth in detail below, examination of the record evidence leads the Property Tax Appeal Board to conclude the 2004 assessment should be increased.

In determining the fair market value of the subject property, the Board examined the appellant's appraisal and the intervenor's appraisal as well as the arguments made by all of the parties. The appraisals utilized the three approaches to value in valuing the subject property, while the board of review's evidence included submission of a grid analysis of suggested sale comparables. The board of review's suggested sales comparables were mostly out-dated sales and the more recent sales comparables did not support the subject's estimated fair market value based on its 2004 assessment as described previously in this decision.

The taxpayer and the intervenor each presented their respective appraisal reports of the subject property to estimate its market value; appellant's appraiser gave an estimate as of January 1, 2003 of $4,000,000 and intervenor's appraiser gave an estimate as of the assessment date of January 1, 2004 of $6,200,000. As noted above, however, in closing arguments intervenor's counsel requested a finding of a fair market value higher than the estimate of its appraiser of $6,460,000. The Board notes that each appraiser who also testified in this proceeding considered the three traditional approaches to value to arrive at a final conclusion of value. Each appraiser also attempted to segregate the "business value" associated with the subject property and then deduct that amount from the final conclusion of the "going concern value" to derive in their respective appraisal reports a final value of the subject property's real estate only.

Both appraisers were in substantial agreement with respect to the description of the subject property. However, the appellant's appraiser did utilize a building size of 59,041 square feet instead of the actual size of 60,275 square feet for purposes of the estimated replacement cost new and for size comparison in the sales comparison approach to value. This constant size error by the appellant's appraiser reflects about a 2% reduction in the actual size of the subject building and thus incorrectly reduces the overall building value in the cost approach and presents a slightly skewed comparison of building sizes in the sales comparison approach of the appellant's appraiser's report.

In the cost approach to value, both appraisers estimated the subject property's land value based on vacant land sales in the area and arrived at identical land value estimates for the subject of $915,000. In developing the replacement cost new of the subject property's improvements, the appraisers both consulted nationally recognized building cost manuals. Appellant's appraiser estimated the building's replacement cost new to be $7,094,345 with indirect costs already included and the intervenor's appraiser estimated the building's replacement cost new to be $8,176,882 including other additions. Besides the difference in building size calculations previously noted in the appellant's submission, intervenor's appraiser also added elements of indirect cost at 5% separately and entrepreneurial profit of 15% to both the building and site improvement replacement cost estimates, thereby increasing the per square foot building and site improvement costs by $23.43 per square foot.

In the cost approach, the intervenor's appraiser chose to make a 15% addition for entrepreneurial profit. The Board finds there was no market data that supported the intervenor's contention that entrepreneurial profit should be added to the replacement costs new at a rate of 15% for both the building and the site improvements. The Board further finds the appraiser failed to provide any support to justify such a substantial addition in the case of a nursing home building which is built to specific specifications and for a special purpose use. The appraiser acknowledged that he was not aware of any nursing home which had been constructed and then sold for a profit. Without such evidence from the market, the addition of entrepreneurial profit for a special use property like this nursing home would be speculative. Thus, the Board finds the intervenor's appraiser's addition for entrepreneurial profit shall be given no weight. On the other hand, the intervenor's appraiser's addition of 5% for indirect costs is an acceptable practice and was also done by the appellant's appraiser.

In summary, appellant's appraiser calculated a replacement cost new of the improvement of $120.16 per square foot of building area and intervenor's appraiser before the unsupported addition of entrepreneurial profit calculated a replacement cost new of the improvement of $118.70 per square foot of building area. Each appraiser asserts they used well-respected valuation services in arriving at their calculations. Utilizing Van Santen's cost figure and the correct square footage of the subject, the replacement cost new estimate for the subject would be $7,242,644 as compared to Solano's adjusted replacement cost new estimate of $7,154,643.

Appellant's and intervenor's appraisers also arrived at similar site improvement values of $244,821 and $297,600, respectively. However, Solano's site improvement calculation must be reduced by the 15% entrepreneurial profit that was inappropriately included as an unsubstantiated addition. Thus, after adjustment, the intervenor's appraiser's estimated site improvement new cost was $260,400.

In conclusion, the Property Tax Appeal Board finds the two appraisers did not differ greatly on the estimated replacement cost new of the improvements (building and site) once size was properly calculated and unsubstantiated entrepreneurial profit was removed. The appellant's appraiser's adjusted estimated replacement cost new of the improvements is $7,487,465 and the intervenor's appraiser's adjusted estimated replacement cost new of the improvements is $7,415,043, a difference of approximately 1%.

The primary difference in the two appraisals in the cost approach was the determination of effective age and as a result of that determination, the amount of depreciation to be applied. Appellant's appraiser estimated an effective age of 31 years, the same as the property's actual age whereas the intervenor's appraiser estimated an effective age of 18 years in light of its condition, market position, "marketability" and other factors. With an economic life of 50 years and utilizing an age/life method, each appraiser then arrived at their respective depreciation calculations. Appellant's appraiser applied depreciation of 62% to both the building and site improvements replacement cost new.

The Property Tax Appeal Board finds that based on the testimony of the appraisers with regard to the condition of the property, the effective age assertion of 31 years made by appellant's appraiser is not supported in the record. While effective age is certainly a subjective determination, there must be some factual basis to support the conclusion. None of the testimony suggested that the subject property appeared to be out-dated or not maintained in terms of the property's physical appearance or maintenance. The property's high occupancy rate further suggests a desirable property. As such, the Board finds it not credible that the property appeared on its face to be 31 years old at the time Van Santen toured the facility. The Property Tax Appeal Board finds that the effective age determination of 18 years by Solano is more persuasive than the effective age determination by Van Santen in light of the testimony of the witnesses.

As such, after deducting for depreciation based on an effective age of 18 years at 36% for the building improvements and 40% for the site improvements and then adding in the land value, appellant's appraiser would find an indication of value of $5,697,185 under the cost approach. Intervenor's appraiser applying depreciation of 36% to the building and 40% to the site improvements would concluding a value of $5,650,212 under the cost approach once the land value was added. These adjusted cost approach figures for the two appraisals can further be defined as $27,523 per bed under Van Santen's adjusted calculations and as $27,296 per bed under Solano's adjusted calculations in the cost approach.

Despite the noted differences in approach by the two appraisers, based on their testimony, it appears that neither appraiser accorded much individual weight to the cost approach since, as evidenced by their varying calculations, there is difficulty in estimating the depreciated value of the improvements by estimating the effective age of the subject property. However, both appraisers did consider it for purposes of cross-checking their two other approaches to value. Furthermore, as will be discussed below, the Property Tax Appeal Board finds given the intrinsic difficulties in determining the business enterprise value to be deducted in both the sales and income approaches to value, in this case the cost approach is a reliable approach to value of the real estate only.

Under the income approach, both appraisers used somewhat similar methodologies to calculate different estimates of value. The appellant's appraiser used the Medicaid rate paid for nursing home residents and an analysis of industry data to arrive at a projected average daily rate per patient day of $138.00 with a stabilized occupancy of 95% to arrive at an estimate of the subject property's potential annual gross income from room and board of $9,905,261. Meanwhile, the intervenor's appraiser used four years of actual income records with an occupancy rate of 97% and an average revenue rate of $136.50 per bed per day to arrive at a stabilized income of $10,003,860. Intervenor's appraiser further noted that average revenue in 2003, the most recent date available, was only $136.34 per resident day. To this figure, intervenor's appraiser deducted a bad debt estimate of $360,000 and added $60,000 for other income for a total estimated income of $9,703,860.

Both appraisers reached similar net operating expenses of $8,247,206 (appellant) and $8,265,000 (intervenor). The appraiser for intervenor made a point in testimony that the historical management fee being charged appeared to be excessive and thus the appraiser estimated an appropriate fee rate of 5% or $485,000. Appellant's appraiser, who set forth historical management fees of 8% and 9% for three years, similarly stabilized the management fee at a lower amount of $495,263. Intervenor's appraiser included an additional deduction for reserves for capital improvements of $100,000 whereas the appellant's appraiser included an additional deduction for return on and of personal property of $166,635. After these deductions, the net operating income before deduction for real estate taxes was also similar between the appraisers: $1,491,419 (appellant) and $1,438,860 (intervenor).

In regard to the capitalization rate to be applied, both appraisers estimated similar capitalization rates of 13%, however, their overall capitalization rates varied slightly at 13.8% (appellant) and 14.44% (intervenor). Appellant's appraiser examined capitalization rates from the five sales comparables which he set forth in his report, published investment surveys, and consideration of the mortgage equity approach in order to arrive at his rate of 13%. To arrive at a capitalization rate, Van Santen utilized income data derived from Medicaid Cost

Reports published by the Illinois Department of Public Health and on page 101 of his report, Van Santen contradicted himself as to whether this data was or was not verified. Intervenor's appraiser examined capitalization rates from five sales comparables set forth in his report and national survey data to arrive at his rate of 13%. On page 103 of his report, appellant's appraiser set forth his methodology in reducing the 2003 effective local tax rate of 2.4% in order to proportionately exclude the business value and/or personal property based on his cost approach; he found about 35% of the total assets of the business were represented by the real estate value, thus resulting in an effective tax rate of .8% (see page 104). On page 71 of his report, intervenor's appraiser set forth a similar methodology based on the 2004 local tax rate and specified 61% as the ratio of taxes allocated to the real estate portion of the total valuation utilizing his cost approach and sales comparison approaches for a tax load of 1.44%. By the capitalization approach, the appraisers, respectively, arrived at market values of $10,800,000, rounded, by appellant's appraiser and $10,000,000, rounded, by intervenor's appraiser.

Next, while both appraisers adjusted this estimate of the total market value of the business by deducting "business value," the Property Tax Appeal Board finds that both appraisers failed to justify their respective calculations and thus presented merely speculation and conjecture. The appellant's appraiser failed to justify his substantial business value deduction to arrive at his final estimate of the property's value. Namely, the appellant's appraiser made a $6,500,000 deduction explained through use of a Medicaid reimbursement rate for land and building without providing any definitive evidence showing the value utilized was present. Likewise, the intervenor's appraiser's determination of a $3,000,000 deduction for business value based upon a 50% estimate of total net income for business profit and HUD guidelines of 25% as reflected on page 73 of his report also was difficult to follow, not explained clearly, and certainly not well supported in the record.

In summary, appellant's appraiser's only adjustment to his conclusion of market value of the total assets of the business under this approach was deduction of his business enterprise value of $6,500,000 resulting in an estimate of value under this approach of $4,300,000. Appellant's appraiser considered two primary methods to arrive at business enterprise value. One method involved simply subtracting the value derived in the cost approach from the value derived in the income capitalization approach. The Property Tax Appeal Board finds this method to lack some credibility given the appraiser's own lack of reliance on the cost approach and the appraiser's questionable effective age determination of 31 years for arriving at depreciation of 62%. Under method one, appellant's appraiser found the business enterprise value to be $7,100,000. The second method considered by the appellant's appraiser involved deducting a capitalized capital cost component (which is built into the Medicaid reimbursement rate) from the market value of the subject as calculated in the income approach. From method two, appellant's appraiser arrived at a business enterprise value of $4,340,000. Given these two figures, appellant's appraiser then chose a business enterprise value of $6,500,000 without much further explanation as to how the methods were reconciled (see page 112 of his report). In this regard, the Property Tax Appeal Board finds the appraiser's explanation of his final conclusion of business enterprise value to lack reliability and credibility.

On the other hand, intervenor's appraiser deducted both an estimate of the contributory value of the personal property of $1,020,000 and an intangible business value of $2,900,000 to arrive at an estimate of market value of the real estate only under the income approach of $6,100,000. The contributory value of personal property was based on published valuation data that replacement cost new would be $8,500 per bed or approximately $1,760,000. The appraiser for the intervenor then estimated an effective age of 5 years and an economic life of 12 years for the personal property resulting in 42% accrued depreciation. This appraiser's calculation of the contributory value of the intangible business interests is set forth on page 73 of his report. In its simplest terms, a HUD guideline was considered of 25% of income, but when that figure failed to adequately reflect the historical income of the subject property, the intervenor's appraiser simply selected a figure of 50% of total net income for business profit in order to adequately reflect the historical income statements of the subject property. Thus, the Board finds the methodology of the appraiser in this instance was a function of the subject's historical income statements and nothing more.

The Board finds the primary difference in the two estimates of value under the income approach is attributable to their respective estimates of business enterprise value. Devoid of any empirical evidence from either appraiser supporting or documenting the worth of the claimed business enterprise value, the Board finds both appraisers' chosen deductions for "business value" to be speculative and given little credence.

Under the sales comparison approach, the appraisers again differed in their results due to their respective deductions of business enterprise value and depreciated personal property values. Before those respective deductions, appellant's appraiser found a value of $53,000 per bed or $10,971,000 and the intervenor's appraiser found a value of $50,000 per bed or $10,350,000. After deducting $6,500,000 in business enterprise value and $517,500 in depreciated personal property, the appellant's appraiser concluded a market value of $4,000,000 based on five sales of nursing homes in downstate Illinois, none of which was located in the subject's market area. After deducting a $3,000,000 business enterprise value and $1,020,000 in depreciated personal property, the intervenor's appraiser, who relied on five sales, one of which was a bulk portfolio sale, in the Chicago area, which is near to Kane County, but still a different market, estimated the subject's market value at $6,330,000.

The Board finds intervenor's bulk portfolio sale much less useful in determining the proper valuation of the subject property particularly where there are such wide-ranging ages (1967 to 1996), land areas (1.81 to 3.62 acres) and building sizes (14,364 to 74,419 square feet) so that the price per bed of $35,708 has been determined not to be a reliable figure for Sale #1 utilized by intervenor's appraiser. Similarly, appellant's appraiser's selection of properties distant from the subject draws into question the reliability of the chosen sales comparables as truly comparable to the subject property. The comparables selected by the respective appraisers reflect a difference of opinion as to which characteristics of similar properties provide a sound basis for estimating the value of the subject property. The Property Tax Appeal Board finds the best comparables are those which reflect local conditions, characteristics and proximity to local amenities that are also convenient to the subject facility. In any event, both appraisers, after considering adjustments to their chosen sales comparables, arrived at remarkably similar assumptions of the sale price per bed of the subject property: $53,000 (appellant) and $50,000 (intervenor).

The courts have stated that where there is credible evidence of comparable sales these sales are to be given significant weight as evidence of market value. In Chrysler Corporation v. Property Tax Appeal Board, 69 Ill. App. 3d 207 (2nd Dist. 1979), the court held that significant relevance should not be placed on the cost approach or income approach especially when there is market data available. In Willow Hill Grain, Inc. v. Property Tax Appeal Board, 187 Ill. App. 3d 9 (5th Dist. 1989), the court held that of the three primary methods of evaluating property for the purpose of real estate taxes, the preferred method is the sales comparison approach. The Board finds there are credible market sales contained in this record, the problem, however, is extracting the value of personal property and business value from the sales price figure which these appraisers have found. Neither appraiser adequately justified their respective deductions on this record.

The Property Tax Appeal Board finds based on the sales comparison approach that the subject property is estimated to have a value of either $10,971,000 or $10,350,000; this results in an estimated price of $53,000 or $50,000 per bed, respectively.

This value determination, however, includes both personal property and business value which are not to be part of the subject's assessed valuation for *ad valorem* tax purposes. From the total estimated sales price, appellant's appraiser deducts $6,500,000 for business value and $517,500 for depreciated personal property to arrive at an estimated market value under the sales comparison approach of $4 million, rounded. Intervenor's appraiser deducts from the total estimated sales price a business value of $3,000,000 and personal property of $1,020,000 to arrive at an estimated market value under the sales comparison approach of $6,330,000, rounded.

Without a valid method by which the Property Tax Appeal Board could ascertain the appropriate values of the subject's personal property and/or business value and after considering the income, sales comparison and cost approaches, the Property Tax Appeal Board has given most consideration to the adjusted cost approach in this matter. After adjustments, the appellant's cost approach is $5,700,000, rounded, and the intervenor's cost approach is $5,650,000, rounded. Based upon this record, the Property Tax Appeal Board finds that the estimated fair market value of the subject property as of January 1, 2004 was $5,675,000. Utilizing the 2004 median level of assessments for Kane County of 33.29% as determined by the Illinois Department of Revenue, the Property Tax Appeal Board finds that the correct assessment of the subject property is $1,889,208. Thus, the Board finds that an adjusted cost approach supports an increase in the assessed valuation of the subject property.

Docket No. 04-00988.001-C-3

This is a final administrative decision of the Property Tax Appeal Board which is subject to review in the Circuit Court or Appellate Court under the provisions of the Administrative Review Law (735 ILCS 5/3-101 et seq.) and section 16-195 of the Property Tax Code.

Chairman

Member

Member

Member

Member

DISSENTING:

C E R T I F I C A T I O N

As Clerk of the Illinois Property Tax Appeal Board and the keeper of the Records thereof, I do hereby certify that the foregoing is a true, full and complete Final Administrative Decision of the Illinois Property Tax Appeal Board issued this date in the above entitled appeal, now of record in this said office.

Date: February 29, 2008

Clerk of the Property Tax Appeal Board

IMPORTANT NOTICE

Section 16-185 of the Property Tax Code provides in part:

"If the Property Tax Appeal Board renders a decision lowering the assessment of a particular parcel after the deadline for filing complaints with the Board of Review or after adjournment of the session of the Board of Review at which assessments for the subsequent year are being considered, the taxpayer may, within 30 days after the date of written notice of the Property Tax Appeal Board's decision, appeal the assessment for the subsequent year directly to the Property Tax Appeal Board."

In order to comply with the above provision, YOU MUST FILE A PETITION AND EVIDENCE WITH THE PROPERTY TAX APPEAL BOARD WITHIN 30 DAYS OF THE DATE OF THE ENCLOSED DECISION IN ORDER TO APPEAL THE ASSESSMENT OF THE PROPERTY FOR THE SUBSEQUENT YEAR.

Based upon the issuance of a lowered assessment by the Property Tax Appeal Board, the refund of paid property taxes is the responsibility of your County Treasurer. Please contact that office with any questions you may have regarding the refund of paid property taxes.