Taxpayers Beware: Appraisal and Court Education Errors Can Doom Your Real Estate Tax Appeal

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The Norfolk Circuit Court recently announced its decision in *United Services Automobile Ass'n v. City of Norfolk*, No. CL10-6578 (Apr. 2, 2012), dismissing the taxpayers' real estate tax assessment appeal. At issue were the City of Norfolk's (the "City") assessments of two parcels that made up United Services Automobile Association's ("USAA") Mid-Atlantic Regional Office. The main parcel consists of 18.963 acres, a 269,246 square-foot office building, and other improvements (collectively the "Office Building").

At trial, the City moved to strike the evidence of USAA and its affiliate, US Real Estate Limited Partnership ("USRE") (collectively the "Taxpayers"), on grounds that the Taxpayers failed as a matter of law to establish the Office Building's fair market value. In its post-trial brief in support of its motion to strike, the City made fallacious arguments regarding fair market value. The court agreed with the City's arguments, granted the motion to strike, and dismissed the case, finding that the Taxpayers' appraisals were "not persuasive"[1] because: (1) the Taxpayers' appraiser advanced a "single," "speculative" theory of highest and best use that violated Virginia's definition of fair market value by not reflecting what a willing seller would accept for the Office Building; and (2) the Taxpayers "did not produce sufficient evidence"[2] that the comparable sales approach was unnecessary and that its omission from the appraisal "would not lead to unreliable results."

Other taxpayers considering real estate tax challenges should glean two important lessons from the court's opinion. First, a taxpayer should be prepared to educate a

court thoroughly, as clearly and simply as possible, on the role of a highest and best use analysis in arriving at fair market value. To aid this education process, the taxpayer's appraiser should include in the appraisal—and be prepared to testify on—the definition of highest and best use, a detailed explanation of the reasons appraisers must arrive at a highest and best use conclusion, a thorough analysis of the legally permissible, physically possible, financially feasible, and maximumly productive uses of the parcel and its improvements, and the rationale for eliminating all but the highest and best use before reaching a fair market value conclusion. It appears the Taxpayers did not succeed in helping the court understand that a proper highest and best use analysis "must reflect the [future] expenditures and improvements necessary to allow the property to achieve its maximum potential," *Ginsberg*, 228 Va. at 641-42, 325 S.E.2d at 353, and that the deductions the appraiser made to arrive at a fair market value as of the dates of the assessments were the same offer price deductions that a prudent, knowledgeable buyer would make for the costs it knew it would have to incur or the losses it knew it would have to absorb to be able to buy the property and bring it to its maximum potential. As a result, the court appears to have concluded incorrectly that a property's current use reflects its highest and best use unless credible evidence shows the property "*cannot continue to function*" in its current use.

Second, a taxpayer should be prepared to educate a court thoroughly on the correct definition of fair market value. To aid this education process, the taxpayer's appraiser should include in the appraisal—and be prepared to testify on—a thorough explanation of each valuation method and the criteria that make each method appropriate (or not) for use, a thorough consideration of the use of each method for the subject property, and a thorough analysis of the reasons for eliminating any method. Moreover, the appraisal should include all three valuation methods to the extent each is capable, within USPAP standards, of producing a credible result.

Appraisal deficiencies or a failure to adequately educate the court can sink a credible tax assessment challenge. Other taxpayers considering real estate tax appeals would be well served to learn from these Taxpayers' experience.

For more information about this topic, please contact the author or any member of the Williams Mullen Southeast State & Local Tax Team.

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[1] The court recognized that the standard of review for deciding a motion to strike required it "to accept as true all evidence favorable to the plaintiff" and "not to judge the weight and credibility of the evidence." Notwithstanding its recitation of the rule, the court's comments regarding the persuasiveness and/or sufficiency of the Taxpayers' evidence indicate that the court weighed the evidence in reaching its decision.

[2] *See* n.1, *supra*. The Taxpayers may have unintentionally conceded the proverbial nail in their appraisals' coffin, stating in their filed proposed findings of fact that eight sales of other office buildings which the appraiser used to calculate his capitalization rate were "comparables." The court appears to have latched onto that concession to conclude that sufficient comparable sales data was available for the appraiser to have included the comparable sales method in his appraisals.

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