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NO. COA13-198

NORTH CAROLINA COURT OF APPEALS

Filed: 17 December 2013

IN THE MATTERS OF:	North Carolina
APPEALS OF:	Property Tax Commission
Hull Story Retail Group	Nos. 08 PTC 240
Shelby Mall LLC; HSCM LLC;	09 PTC 152
Hull Story Gibson Companies LLC	09 PTC 153
from the decisions of the	10 PTC 317
Cleveland County Board of	10 PTC 318
Equalization and Review	11 PTC 227
concerning the valuations	
of real property.	

Appeal by taxpayer from final decision entered 30 November 2012 by the North Carolina Property Tax Commission. Heard in the Court of Appeals 6 June 2013.

Bell, Davis & Pitt, P.A., by John A. Cocklereece, Jr. and Justin M. Hardy, for taxpayer-appellant.

Parker Poe Adams & Bernstein, LLP, by Charles C. Meeker and Katherine E. Ross, for respondent-appellee.

DAVIS, Judge.

Taxpayer Hull Storey Gibson Companies, LLC and its affiliates (collectively "HSGC") appeal from the final decision

of the North Carolina Property Tax Commission ("the Commission") valuing several parcels of HSGC's real property encompassing the Cleveland Mall for *ad valorem* tax purposes at a value of \$13,254,491. After careful review, we affirm.

Factual Background

The real property at issue in this case consists of four parcels of land owned by HSGC and located in Cleveland County. These parcels, in aggregate, total approximately 35.4 acres and include (1) three parcels, totaling 33.9 acres, improved with an enclosed retail mall ("the Mall Property"); and (2) an unimproved 1.5-acre parcel ("the Outparcel") adjacent to the Mall Property. For *ad valorem* tax purposes, respondent Cleveland County ("the County") valued the Mall Property at \$9,484,687 and the Outparcel at \$183,967 as of 1 January 2008 ("the valuation date"). HSGC appealed the County's valuations to the Cleveland County Board of Equalization and Review, which confirmed the County's assessment in a decision issued 12 June 2008. HSGC then appealed that decision to the Commission. The County subsequently used the same valuations for the Mall Property and the Outparcel for tax years 2009 through 2011, and HSGC likewise appealed these assessments to the Commission. On

19 October 2011, the Commission consolidated all of the appeals into a single case for review.

The Commission conducted an evidentiary hearing on 14 and 15 February 2012. HSGC produced appraisal reports prepared by real estate appraisers Paul G. Carter, Jr. ("Carter") and James M. Hull ("Hull"). Both Carter and Hull used the "income approach" valuation method¹ in forming their opinions regarding the valuation of the Mall Property. Carter valued the Mall Property at \$6,930,000, and Hull valued them at \$4,915,000. The County presented expert witness testimony and an appraisal report from Chris Green ("Green"), a county tax administrator. Green likewise employed the income approach methodology in valuing the parcels but arrived at a value of \$13,254,491 for the Mall Property and \$812,309 for the Outparcel.

The Commission entered its final decision on 30 November 2012, concluding, with respect to the Mall Property, that (1) HSGC had produced evidence showing that the County's initial \$9,484,687 valuation was the result of an arbitrary valuation method and did not reflect the Mall Property's market value; (2) the County had failed to meet its burden of proving that its 2008 valuation reflected the market value of the property; and

¹ This valuation method is also referred to as the "income capitalization approach."

(3) the market value of the Mall Property for *ad valorem* tax purposes was \$13,254,491. As for the Outparcel, the Commission determined that the County's initial valuation of \$183,967 correctly reflected the property's market value. Accordingly, the Commission upheld the County's valuation of the Outparcel but ordered the County to revise its tax records to reflect the Commission's valuation of the Mall Property for tax years 2008 through 2011. HSGC appealed to this Court.²

Analysis

When reviewing decisions of the Property Tax Commission, this Court

may affirm or reverse the decision of the Commission, declare the same null and void, or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the appellants have been prejudiced because the Commission's findings, inferences, conclusions, or decisions are:

- (1) In violation of constitutional provisions; or
- (2) In excess of statutory authority or jurisdiction of the Commission; or
- (3) Made upon unlawful proceedings; or

²In appealing from the Commission's final decision, HSGC does not challenge the Commission's determination that the market value of the Outparcel is \$183,967. Therefore, our analysis is limited to HSGC's challenge to the Commission's decision as to the valuation of the Mall Property.

- (4) Affected by other errors of law; or
- (5) Unsupported by competent, material and substantial evidence in view of the entire record as submitted; or
- (6) Arbitrary or capricious.

N.C. Gen. Stat. § 105-345.2(b) (2011).

The first four grounds under § 105-345.2(b) involve questions of law, which are reviewed *de novo* on appeal. *In re Appeal of Greens of Pine Glen Ltd. P'ship*, 356 N.C. 642, 647, 576 S.E.2d 316, 319 (2003). Pursuant to this standard, the reviewing court "considers the matter anew and freely substitutes its own judgment for that of the Commission." *Id.*

The last two bases are reviewed under the "whole record" test. *Id.* Under this standard, in contrast to *de novo* review, this Court may not substitute its judgment for that of the Commission as between reasonable conflicting views of the evidence. *In re McElwee*, 304 N.C. 68, 87, 283 S.E.2d 115, 127 (1981). Instead, the reviewing court's function is limited to determining whether the Commission's decision has a "rational basis in the evidence." *Id.*

I. Burden-Shifting Framework

It is "a sound and a fundamental principle of law in this State that ad valorem tax assessments are presumed to be

correct." *In re Appeal of AMP, Inc.*, 287 N.C. 547, 562, 215 S.E.2d 752, 761 (1975). Thus, "when such assessments are attacked or challenged, the burden of proof is on the taxpayer to show that the assessment was erroneous." *Id.* at 562, 215 S.E.2d at 762. In order for the taxpayer to rebut the presumption of correctness, the taxpayer must produce competent, material, and substantial evidence tending to show that (1) the taxing authority used either "an arbitrary method of valuation" or "an illegal method of valuation;" and (2) "the assessment substantially exceeded the true value in money of the property." *Id.* at 563, 215 S.E.2d at 762 (emphasis omitted).

In rebutting the presumption of correctness, the burden on the taxpayer "is one of production and not persuasion[.]" *In re Appeal of IBM Credit Corp.*, 186 N.C. App. 223, 226, 650 S.E.2d 828, 830 (2007) (*IBM I*), *aff'd per curiam*, 362 N.C. 228, 657 S.E.2d 355 (2008). If the taxpayer rebuts this presumption, "[t]he burden of going forward with evidence and of persuasion that its methods would in fact produce true values" shifts to the taxing authority. *In re S. Ry. Co.*, 313 N.C. 177, 182, 328 S.E.2d 235, 239 (1985). At that juncture, it is "the Commission's duty to hear the evidence of both sides, to determine its weight and sufficiency and the credibility of

witnesses, to draw inferences, and to appraise conflicting and circumstantial evidence, all in order to determine whether the [taxing authority] met its burden." *Id.*

N.C. Gen. Stat. § 105-283 requires taxing authorities to value property for *ad valorem* tax purposes at its "true value in money," which is its "market value." N.C. Gen. Stat. § 105-283 (2011). Market value is defined as

the price estimated in terms of money at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used.

N.C. Gen. Stat. § 105-283.

Pursuant to N.C. Gen. Stat. § 105-317, "[i]n determining the 'true value' of real property, an appraiser must consider, among other things, its 'replacement cost; cost; adaptability for residence, commercial, industrial, or other uses; past income; probable future income; and any other factors that may affect its value.'" *Greens of Pine Glen*, 356 N.C. at 648, 576 S.E.2d at 320 (quoting N.C. Gen. Stat. § 105-317(a)(2)). This statute "has been interpreted as authorizing three methods of valuing real property: the cost approach, the comparable sales approach, and the income approach." *Id.* For investment

properties, such as the retail mall at issue in this case, "[i]t is generally accepted that the income approach is the most reliable method in reaching the market value" of such properties. *In re Appeal of Belk-Broome Co.*, 119 N.C. App. 470, 474, 458 S.E.2d 921, 924 (1995), *aff'd per curiam*, 342 N.C. 890, 467 S.E.2d 242 (1996).

II. Application of Burden-Shifting Framework

The Commission made the following pertinent findings of fact addressing the burden-shifting framework discussed above:

10. Cleveland County, on the valuation date, assessed the Subject Property at a total value of \$9,668,654, of which, \$9,484,687 is attributable to the Mall Parcels and \$183,967 is attributable to the Outparcel.

11. [HSGC] contends, as [of] the valuation date, that the Subject Property's fair market value was \$6,981,000, namely; \$6,930,000 is attributable to the Mall Parcels and \$51,000 is attributable to the Outparcel.

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15. The primary evidence offered by [HSGC] at the hearing was the testimonies of Mr. James Hull and Mr. Paul Carter. Mr. Hull and Mr. Carter, being duly qualified, testified as to their opinions of the market value for the Mall Parcels and Outparcel.

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17. The Commission recognizes that Mr. Carter prepared an appraisal report wherein

he only used the income capitalization approach to estimate his opinion value for the subject Mall Parcels. In his report, Mr. Carter states that he relied upon the income capitalization approach because investors making up the market for income-producing properties such as the subject mall are primarily motivated by the economics of ownership and the income capitalization approach is by far the most applicable valuation approach because it best considers their investment requirements.

. . . .

19. When relying upon the income capitalization approach, [HSGC's] appraiser reached an estimated opinion of value of \$6,930,000 for the subject Mall Parcels, effective January 1, 2008. Mr. Carter testified that he used market rents, and then performed a market analysis with regard to vacancy and expenses. As such, Mr. Carter arrived at a market value of \$6,930,000 for the subject Mall Parcels by using a tax loaded overall capitalization rate of 14.155%. Mr. Carter arrived at his estimated opinion of value as follows:

Stabilized net operating income (NOI)
excluding real estate taxes:
\$951,191

Divided by the tax-loaded overall
capitalization rate:
0.1455

. . . .

21. [HSGC] provided evidence, applying the income approach, that tends to show that Cleveland County used an arbitrary method of assessment.

22. Consequently, [HSGC] did rebut the initial presumption of correctness as to Cleveland County's assessment of the Subject Mall Property by offering evidence tending to show that Cleveland County used an arbitrary method of assessment and that Cleveland County's assessment of the Subject Mall Property did not reflect true value which is "market value." N.C. Gen. Stat. § 105-283. When Cleveland County primarily relied upon the 2008 schedule of values, standards and rules, without further evidence to establish value, the [C]ounty's assessment of the Subject Mall Property was substantially lower than the true value in money of the property as of January 1, 2008.

23. Consequently, the burden then rests with Cleveland County to go forward with the evidence and of persuasion that its methods would in fact produce true value; and it is the Commission's duty to hear the evidence of both sides, to determine its weight and sufficiency, and the credibility of witnesses, to draw inferences, and to appraise conflicting and circumstantial evidence, all in order to determine whether the County met its burden.

Thus, the Commission determined that HSGC met its initial burden of production and thereby rebutted the presumption of correctness.

Initially, we note that in articulating its findings regarding its application of the burden-shifting framework, the Commission misstated the applicable law. As discussed above, a taxpayer rebuts the presumption of correctness only when he

presents competent, material, and substantial evidence tending to show that the County's assessment used an arbitrary or illegal method which produced an assessment that *substantially exceeded* the true value of the property. *In re Appeal of Parkdale Am.*, 212 N.C. App. 192, 194, 710 S.E.2d 449, 451 (2011). Consequently, when the Commission stated in Finding 22 that HSGC met its burden by showing that the County used an arbitrary method that produced an assessment that "*did not reflect true value*" of the Subject Mall Property, the Commission failed to properly recite the burden-shifting standard (Emphasis added.).

However, we do not believe that this misstatement of the applicable standard requires remand because (1) neither party challenges the Commission's determination that HSGC rebutted the presumption of correctness; and (2) the record clearly establishes that HSGC did in fact produce competent evidence that tended to show (a) the County's 2008 assessment was arbitrary because it failed to utilize the income approach; and (b) the County's initial assessment of \$9,484,687 substantially exceeded the \$6,930,000 income approach-based valuation offered by HSGC's appraiser. See *In re Blue Ridge Mall LLC*, 214 N.C. App. 263, 272, 713 S.E.2d 779, 785 (2011) ("[The taxpayer's]

appraisal, valuing the property at \$7,735,000, was competent, material, and substantial evidence tending to show that the County's assessment [of \$11,496,600] was substantially in excess of the true value in money of the property."). Thus, despite the Commission's erroneous explanation of *why* HSGC had met its burden of production and shifted the burden to the County, its conclusion that HSGC had, in fact, successfully shifted the burden was correct.

The Commission then properly proceeded to shift to the County the burden "to go forward with the evidence and of persuasion that its method would in fact produce true value." The County acknowledged that its initial 2008 valuation of the Mall Property did not utilize an income approach. It then, however, offered evidence of an income approach valuation of the Mall Property conducted by Green that yielded a value of \$13,254,491. Green testified at length regarding his valuation, and his calculations were introduced during the hearing as the County's Exhibit 5.

After hearing the parties' evidence regarding valuation, the Commission concluded that the County had failed to show that its initial valuation of \$9,484,687 reflected the true value of the Mall Property because the true value was actually higher

than the County's assessed value. Specifically, the Commission found as follows:

31. . . . [W]hen considering that Cleveland County's *ad valorem* assessment of the subject Mall Parcels did not reach "true value" of the property as that term is defined by N.C. Gen. Stat. § 105-283; and when considering that the subject property is surrounded by a substantial construction project, and is adjacent to high quality retail outparcels that include, but are not limited to, a major retail automotive dealership, both of which increase the value associated with the property; and giving due consideration to the fact that this is the only mall in Cleveland County, the true value in money, which is market value, as defined in N.C. Gen. Stat. § 105-283, for the subject Mall Property was \$13,254,491 as of January 1, 2008.

Accordingly, we must review the Commission's findings supporting its valuation to determine whether its determination was supported by competent, material, and substantial evidence.

We first note that pursuant to N.C. Gen. Stat. § 105-290, the Commission has the authority "[on] the basis of the findings of fact and conclusions of law made after any hearing[,] . . . [to] enter an order . . . reducing, *increasing*, or confirming the valuation or valuations appealed" N.C. Gen. Stat. § 105-290(b)(3) (2011) (emphasis added). Thus, in appropriate circumstances, the Commission may increase the taxing authority's initial valuation of property so long as its

decision is supported by competent, material, and substantial evidence.

The weight and credibility to be assigned to the evidence before it is for the Commission to determine. *In re Weaver Inv. Co.*, 165 N.C. App. 198, 202, 598 S.E.2d 591, 593, *disc. review denied*, 359 N.C. 188, 606 S.E.2d 695 (2004). "[T]his Court may not reweigh the evidence or substitute its own evaluation of the evidence for that of the Commission." *In re Appeal of Interstate Income Fund I*, 126 N.C. App. 162, 165, 484 S.E.2d 450, 452 (1997) (citation and quotation marks omitted).

HSGC contends that the Commission's conclusion that \$13,254,491 reflected the true value of the Mall Property is arbitrary and unsupported by the evidence of record because Green's income approach valuation utilized (1) inaccurate leasing data; (2) an incorrect net operating income amount; and (3) an erroneous capitalization rate. We address each of these contentions in turn and apply the whole-record test to determine whether the Commission's ultimate valuation was supported by sufficient evidence of record. *See Greens of Pine Glen*, 356 N.C. at 647, 576 S.E.2d at 319 ("[I]ssues [concerning the] sufficiency of the evidence to support the Commission's decision are reviewed under the whole-record test.").

A. Leasing Data

HSGC first asserts that Green's income approach valuation of the Mall Property was improper because Green did not have accurate and up-to-date tenant and lease information and did not physically visit the Mall Property in order to obtain current data. The failure to conduct a physical visit to the property at issue is not, standing alone, sufficient cause to set aside a valuation. See *Weaver Inv. Co.*, 165 N.C. App. at 204, 598 S.E.2d at 595 ("While the failure to perform a physical evaluation is not in and of itself grounds for setting aside the County's valuation, it is a factor to be considered when determining whether the County's valuation was arbitrary or illegal.").

At the hearing, Green testified that he examined lease and tenant information from 2001 because HSGC failed to provide him with more current data despite his request that it do so. HSGC contends that the 2001 information was outdated and caused Green's appraisal to be inaccurate and arbitrary. However, it is well established that in conducting an income approach valuation, the assessor utilizes market rents rather than the actual rents charged to lease space in the subject property. See *Greens of Pine Glen*, 356 N.C. at 649, 576 S.E.2d at 320

("This Court has consistently held that where the income approach is used, the valuation must be based on market rents, not contractually restricted rents."). In accordance with this approach, Green based his valuation of the Mall Property not on the actual rent paid for space in the mall but rather on market rents derived from "what spaces would most typically bring in the open market" at comparable malls. Indeed, Green also explained that the 2001 lease plan was "only used in establishing the square footage of each individual shop so that we could then categorize those and assign a market rent based on the area of that shop." Thus, we cannot conclude that the Commission erred in relying on Green's analysis simply because he did not have current leasing information within the Mall Property when conducting his valuation.

B. Net Operating Income

HSGC next argues that Green employed "improper methods to derive a flawed net operating income." Specifically, HSGC claims that Green's use of the market information collected and employed by Carter in his 2007 appraisal of the Blue Ridge Mall — located in Hendersonville, North Carolina — was an inappropriate means of calculating net operating income because Green "made no attempt to adjust Carter's Blue Ridge Mall

figures to account for differences between the two markets, properties, or dramatic changes in the economy"

On direct examination, Green testified as follows regarding his calculation of the Mall Property's net operating income:

Q Okay. What did you do next?

A Looking at the comparable sales and the market rent information that was available to me, that Mr. Carter had done, which I recognized as being by the market, comparable market rents, I tried as best as I could to categorize the shops in the Cleveland Mall and apply Mr. Carter's market rents to those shops, because I felt like that what he had - the work that he had done on that was - in fact, he had chosen to use three of the four identical comps for both malls. So I looked at that as being a reliable source of market rent.

Q Okay. And that came, actually, from the Blue Ridge Mall appraisal; is that correct?

A Yes, sir.

Q And it used three of the four same malls that were used here. Is that right?

A Yes.

Q Okay. And so, you used his rents for shops, depending on the size of the shops, and his rents for anchors. Is that right?

A Yes.

Q And that got you your potential gross rent; is that correct?

A Yes.

Q And that's the 2.5 million figure, approximately. Is that right?

A Yes.

Q What did you do next?

A I also used the vacancy and collection loss of 15 percent overall. This was, as it turns out was right about the actual vacancy rate for Cleveland Mall and Blue Ridge Mall at the respective appraisal dates. I felt it was appropriate to use here. So, I applied the 15 percent vacancy and collection loss against the potential.

Q So, in addition to being in Mr. Carter's appraisal for Blue Ridge Mall, you also thought, in your own opinion, that was correct. Is that right?

A Yes.

Q And that was the same as the potential gross rent; you thought the market rents were fair. Is that right?

A Yes.

Q Okay. What happened next?

A For any additional income, percentage rent, CAM, the insurance reimbursement, again, I took Mr. Carter's numbers to be very reliable from the market rate standpoint and applied the exact same percentage rent and the same percentage CAM and insurance per square foot - per gross leasable area, and applied that to our individual shop spaces.

Q Okay. And then you got to effective

gross income of 2.298 million. Is that correct?

A Yes.

Q And what did you do next?

A Okay. We needed to come up with a market expense estimate again, recognize that Mr. Carter already had very comparable market income and expense information for all the components that you see in that operating expense, applied those against the - the square footage, the gross leasable area in the Cleveland Mall, omitted the real estate taxes, and came up with an expense that will reflect the same market expenses per square foot comparable to Blue Ridge Mall.

Q And did you think those expenses were correct in terms of the Cleveland Mall?

A Yes.

Q So, in addition to using Mr. Carter's, your own opinion was these appeared to be fair. Is that correct?

A Yes.

Q Okay. What was your net operating income?

A 1,391,722.

Green's testimony indicates that while he relied on various information contained in Carter's earlier appraisal of the Blue Ridge Mall, he did so because, in his opinion, the two malls were comparable properties and Carter's figures were reliable.

As expert witnesses have "wide latitude in gathering information" upon which to base their opinions, *Shields v. Nationwide Mut. Fire Ins. Co.*, 61 N.C. App. 365, 375, 301 S.E.2d 439, 446 (citation and quotation marks omitted), *disc. review denied*, 308 N.C. 678, 304 S.E.2d 759 (1983), we cannot agree with HSGC's contention that Green's use of the market information used in the Blue Ridge Mall appraisal was arbitrary or capricious. HSGC's argument ignores the fact that

[t]he whole-record test is not a tool of judicial intrusion. We may not substitute our judgment for that of the Commission even when reasonably conflicting views of the evidence exist. It is the responsibility of the Commission to determine the weight and credibility of the evidence presented. The Commission — unlike the courts — has the staff, the specialized knowledge, and experience necessary to make informed decisions upon questions relating to the valuation and assessment of property.

Blue Ridge Mall LLC, 214 N.C. App. at 275, 713 S.E.2d at 787 (internal citations, quotation marks, and brackets omitted).

C. Capitalization Rate

Finally, HSGC asserts that the capitalization rate used by Green was arbitrary because he adopted the same capitalization rate used by the Commission in connection with its valuation of the Blue Ridge Mall "without critical thought or analysis." At the hearing, Green testified as follows:

Q Okay. And then what cap rate did you use?

A I used a 10.5 cap rate.

Q What was the basis for that?

A Cap rates that we observed in our older work were somewhere around the 10, 10 percent cap rate. We had seen downward trend from the national trends, and knowing also that this Commission's decision, where they used a 10.5 on a very similar property just one year prior. For the purposes of this hearing, I chose to use the 10.5.

Q Does the Korpacz [Real Estate Investor Survey]³ rate of 9.85 percent also support a roughly 10.5 rate?

A It's within that range, yes.

Q And is it your judgment, based on your experience, that 10.5 is a fair rate for the Cleveland Mall as of January 1, 2008?

A Yes, sir.

This testimony explains Green's thought processes regarding his decision to use a capitalization rate of 10.5%. Accordingly, his testimony constitutes competent evidence upon which the Commission was entitled to rely, and this Court cannot accept HSGC's invitation to substitute our view for that of the Commission in assigning the weight to be accorded to this evidence. See *Interstate Income Fund I*, 126 N.C. App. at 165,

³ The Korpacz Real Estate Investor Survey is a national real estate survey.

484 S.E.2d at 452 ("[T]his Court may not reweigh the evidence or substitute its own evaluation of the evidence for that of the Commission.") (citation and quotation marks omitted)).

In a related argument, HSGC contends that Green "intentionally ignored" a capitalization rate that would have produced a less favorable assessment for the County. Specifically, HSGC asserts that Green did not use the capitalization rate employed in connection with the valuation of the Wilson Mall because he knew that using that capitalization rate would have resulted in a lower valuation of the Mall Property. However, the transcript does not support this contention. Green testified that while he could have adopted the capitalization rate used for the Wilson Mall, he chose not to do so because he had never been to that mall. He explained: "I was not familiar with the Wilson Mall, whereas I was the Blue Ridge Mall, and knowing how similar it was I felt like that it was about as comparable as any two malls can be." Contrary to HSGC's argument, Green's testimony does not suggest that he improperly excluded the Wilson Mall from his consideration in order to inflate his valuation of the Mall Property. Moreover, any weight to be accorded to Green's decision to exclude the Wilson Mall from his valuation process

was within the purview of the Commission.

Conclusion

For the reasons stated above, we affirm the Property Tax Commission's final decision regarding the valuation of the Mall Property.

AFFIRMED.

Judges CALABRIA and STROUD concur.

Report per Rule 30(e).