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IN THE SUPREME COURT OF THE STATE OF OREGON

DEPARTMENT OF REVENUE, State of Oregon; and DESCHUTES COUNTY ASSESSOR, Plaintiffs-Appellants, v. RIVER'S EDGE INVESTMENT, LLC, Defendant-Respondent	Tax Court No. 4962 Supreme Court No. S062829

APPELLANT'S REPLY BRIEF

Appeal from the Judgment of the Oregon Tax Court
The Honorable Henry C. Breithaupt, Judge

CONTINUED ON NEXT PAGE

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08/21/15

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes

Other Authorities

Rules

REPLY BRIEF OF APPELLANT DEPARTMENT OF REVENUE

A. Measure 50 does not prohibit consideration of property outside the tax account under appeal when determining that property's highest and best use and real market value.[1]

In its answering brief, River's Edge echoes the tax court's error: concluding that because "property" means "all property included in a single property tax account" for purposes of determining maximum assessed value (MAV), "it follows" that property outside of a tax account cannot be considered in determining real market value (RMV). What River's Edge and the tax court fail to explain is why this conclusion "follows." ORS 308.142 clearly states that its definition of "property" applies "for the purposes of determining whether the assessed value of property exceeds the property's maximum assessed value permitted under section 11, Article XI of the Oregon Constitution." River's Edge provides no legislative or judicial authority to support their assertion that this definition of property also

[1] River's Edge argues that the department failed to preserve its argument that the tax court incorrectly construed and applied Measure 50. Although the tax court mentioned the "dirty little secret of Measure 50" as rendering real market value meaningless, the court did not state a belief that real market value and highest and best use must be determined in conformance with the "single tax account" provisions of Measure 50 during trial. That conclusion first appeared in its written opinion. Neither party anticipated this by addressing Measure 50 in post-trial briefing. Moreover, even if the ordinary rules of preservation were applicable, the record shows that Mr. Adair, counsel for the department, attempted to respond to the court's invitation to address the court's Measure 50 concerns (to the extent they were known at that time), but the court did not allow it. (Tr 432-433, 534-536)

applies for purposes of determining the RMV of property under ORS 308.205, and neither the text, context, or voter understanding of Measure 50 supports that conclusion. As explained in the department's opening brief, a property tax account is merely an administrative construct, and does not dictate the highest and best use of property for determining its real market value.

As this court recently observed in *Hewlett-Packard Co. v. Benton County Assessor*, 357 Or 598, 602, __ P3d __, 2015 WL 4658907 (2015), the department's rule (OAR 150-308.205-(D)(1)(c)) defines highest and best use as "'the reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, and financially feasible, and that results in the highest value. See The Appraisal of Real Estate, 12th edition (2001).'"[2] The opinion further explains that

> To find a property's highest and best use, an appraiser identifies the property's potential alternative uses and tests them against the criteria set out in the department's definition of highest and best use. Those alternative uses "may include, among others, all possible uses that might result from retaining, altering or ceasing the integrated nature of the unit of property." OAR 150-308.205-(D)(3)(i). For an improved property, those alternative uses often consist of "continuation of the existing use, renovation or rehabilitation, expansion, adaptation or

[2] The highest and best use rules cited by this court in *Hewlett-Packard* are for an industrial facility. The department has adopted identical rules for commercial properties such as the River's Edge convention center. *See* OAR 150-308.205-(A)(1)(d) and OAR 150-308.205-(A)(2)(i).

> conversion to another use, partial or total demolition, or some combination of these alternatives."

Id. at 602-03 (quoting Appraisal Institute, *The Appraisal of Real Estate* 315 (12th ed 2001)).

For both industrial and commercial properties, "unit of property" is defined as "the item, structure, plant, or integrated complex as it physically exists on the assessment date." OAR 150-308.205-(A)(1)(a) and OAR 150-308.205-(D)(1)(a). The tax account(s) are not mentioned. Here, the River's Edge convention center is in close proximity to the hotel rooms, connected to the River's Edge Hotel via walkways and an underground tunnel, and is operated and advertised as an integrated facility. (Tr 1028-1030, Ex 13) No other hotel in Bend can claim the convention center as a featured part of its hotel. (Ex 13 at 3, 7)[3] Acceptance of River's Edge's argument—that Measure 50 requires an appraiser to look only at a single tax account in determining the highest and best use of a unit of property—

[3] The design and use of the convention center facility as a featured component of the Riverhouse Resort is beneficial in this way only to the Riverhouse Resort, which meets the definition of especial property in OAR 150-308.205-(A)(3). As described in the rule, the convention center facility was "specially designed, equipped, and used" specifically for meeting facilities as part of the Riverhouse Resort complex. Other hotels such as the Shilo may provide spillover lodging to persons attending meetings, but only River's Edge controls the scheduling of meetings and hotel room meeting packages. Selling the convention center facility off for operation as a stand-alone facility would not provide the same utility to the Riverhouse Resort.

would preclude application of the analysis required by the department's rules and this court's decision in *Hewlett-Packard*.

River's Edge next argues that consideration of property outside the tax account would lead to impermissible "double counting" because consideration of hotel revenue in the valuation of the convention center would result in an increase to both properties. But this is not the case, as the department's expert appraiser testified: a properly conducted income approach would allocate the combined income between both properties using a cost approach. (Tr 1148-1150) Furthermore, as to River's Edge's suggestion that allowing an appraiser to look beyond the tax account would lead to inclusion of the golf course, the department responds that inclusion of the golf course might well be proper if, e.g., income and expenses are commingled with those of the rest of the resort, as the department's appraiser testified is the case for the hotel and convention center.

River's Edge also argues that the property is not especial property for the purposes of ORS 308.205(c) and OAR 150-308.205-(A)(3), and concludes that "the Department's appraiser had no legal basis to consider the neighboring hotel in determining the highest and best use and real market value of the subject property."[4]

[4] This conclusion suggests that if the property were especial, then the department could have considered the neighboring hotel in determining highest and best use and RMV. But the tax court's holding that property outside of a tax account cannot be considered in determining a property's RMV did not turn on whether or

This argument conflates the highest and best use determination with selection of appraisal approaches based on a determination that the property is especial use, so we address each separately.

First, River's Edge ignores evidence in the record that supports considering the hotel in determining the highest and best use of the convention center property. Exhibits 28 and 29 contain City of Bend Ordinance No. NS-1951 and Findings supporting approval of the Development Agreement, which is statutorily authorized pursuant to ORS 94.504-528. These documents show that the convention center was approved in the Commercial Limited (CL) Zone as "new facilities as part of an existing hotel and resort complex," not a stand-alone convention center. (Ex 29 at 20; *see also id.* at 8-9) And the CL Zone parking requirements were less for the convention center used with the hotel than would have been required for a stand-alone convention center. The property was classified as mixed use—"Convention Hotel"[5]—due to the close proximity and connection to the existing Riverhouse complex. (Ex 29 at 99; *see also id. at* 83, 85) These exhibits show that the

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not the property was considered "especial." It applied to the valuation of all properties, not just especial properties.

[5] The property was classified as a "Convention Hotel" in the Parking Generation, 2nd Ed., published by the Institute of Transportation Engineers, which the City of Bend relied on in the Findings supporting approval of Ordinance No. NS-1951. (Ex 29 at 83)

department's appraiser had a legal basis to consider the adjacent hotel in making his highest and best use determination, and further show that the stand-alone convention center highest and best use concluded by the River's Edge appraiser would not have been legally permissible.

River's Edge also makes the assertion that the Development Agreement constitutes a government constraint that requires the highest and best use of the convention center to be a continuation of that use: "But for the Development Agreement, a convention center would not be the subject property's highest and best use."[6] (Resp Br 2 n 1) In making this assertion, River's Edge is attempting to bolster its appraiser's unrealistically low income approach indicator—a value that is low relative to both their cost approach and the departments, and so low that it is below the value of the bare land.[7] However, the language of the Development

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[6] In the same paragraph of its brief, River's Edge cites ORS 308.205(2)(d) as support for this argument. However, that statute is inapt. The statute merely requires real market value of a government restricted property to be based on sales that reflect the same government restriction, unless they can be satisfactorily adjusted. Neither party's appraiser used sales in a sales comparison approach so the statute does not apply here, except to the extent the River's Edge appraiser failed to heed it in using the one sale of a noncomparable, nonprofit-owned convention center in his income approach. (Tr 886-892, 1146-1147)

[7] The tax court made no finding that the property was subject to a governmental restriction pursuant to ORS 308.205(d)(A) because of the Development Agreement. (ER 6-7) And River's Edge's own witness, Oran Teater, the mayor of Bend at the time the Development Agreement was signed, testified that he did not recall anything in the Development Agreement that would prevent River's Edge

Agreement does not support this assertion. It provides in the first paragraph: "Nothing in this Agreement limits use of any of the Property for other lawful purposes, so long as any required Permits are obtained." (Ex 1 at 96)

Second, the argument that River's Edge is not especial property is refuted by the appraisal evidence in the record. Neither party's appraisal contains a sales comparison approach because there were insufficient sales. This means the subject property had "no immediate market value." ORS 308.205(2)(c). River's Edge relies on the speculative testimony of several witnesses to show a general market. But statements from paid witnesses that they "would sell" the property on a stand-alone basis is not market evidence of actual comparable sales transactions. River's Edge presented no sales of privately owned convention centers that could be used to determine an "immediate" market value for the subject property, as contemplated by the language of ORS 308.205(2)(c).[8] River's Edge further argues that the convention center is not especial use property under OAR 150-308.205-(A)(3),

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from tearing down the convention center. (Tr 1001-1002) Therefore, the record does not support a real market value of the property as improved that is less than the value of the bare land.

[8] River's Edge introduced rebuttal Exhibit J through its appraiser to show that sales of much smaller and older meeting facility properties had taken place in other parts of the country in 2000, 2009, and 2012, but no evidence leading up to the January 1, 2008, appraisal date. The appraiser acknowledged that the properties sold were not comparable to the subject property. (Tr 589-598)

quoting the tax court's order awarding attorney fees, because the property is beneficial to more than one user. However, OAR 150-308.205-(A)(3) qualifies its first sentence beneficial use requirement in the next sentence: "This may occur because the especial property is part of a larger total operation or because of the specific nature of the operation or use." As the department's evidence shows, the convention center was "designed" and "used as part of a larger total operation"—the Riverhouse Resort. *Id*. (*See, e.g.*, Exs 1, 28, 29)

B. The tax court misinterpreted and misapplied OAR 150-308.205-(A)(3) when it refused to consider the department's appraiser's cost approach.

OAR 150-308.205-(A)(3) provides that for especial property, "[r]eal market value must be determined by estimating just compensation for loss to the owner of the unit of property through either the cost or income approaches, whichever is applicable, or a combination of both." River's Edge contends the tax court correctly gave no weight to the department' appraiser's cost approach because it was not satisfied with the appraiser's testimony explaining why an income approach had not been completed. In answer to the department's attorney fees assignment of error, River's Edge quotes at length from the tax court's questions regarding the department's appraiser's reasons for not completing an income approach. In the quoted transcript excerpts, the tax court interrupts the appraiser's answers to the questioning four times. In the full transcript discussion from which these excerpts

are drawn, the tax court interrupts the appraiser's attempted answers fourteen times. (Tr 1112-1115) Thus, it is not surprising that by the end of the discussion the appraiser was "wishing" he had completed an income approach—however inappropriate. (Tr 1113-1114) The appraiser was perhaps attempting to repeat the detailed explanation of his reasons for not completing an income approach, which he had already given in direct examination by the department's attorney and in cross-examination by the River's Edge attorney, and in his appraisal report. (*See*, *e.g.*, Tr 419-420, 425-426, 514-518; Ex 1 at 40-41) As discussed in the opening brief, the department's appraiser had well-founded reasons for not completing an income approach, but even if the concerns about lack of an income approach were reasonable, the court had no discretion to completely disregard the department's appraiser's cost approach. Neither OAR 150-308.205-(A)(3), nor any other rule or statute provides that the tax court may refuse to consider one approach to value simply because the appraiser did not conduct another approach to value.

The tax court should have considered all evidence on the record before making its determination that the income approach was the most reliable indicator of value. *See Pacific Power & Light Co. v. Department of Revenue*, 286 Or 529, 596 P2d 912 (1979) ("whether in any given assessment one approach [to value] should be used exclusive of the others or is preferable to another or to a combination of approaches is a question of fact to be determined by the court upon the record.").

Instead of engaging in this analysis, the tax court erroneously construed OAR 150-308.205-(A)(3) and refused to consider a portion of the record (the department's cost approach).

C. The tax court's award of attorney fees was an abuse of discretion.

River's Edge disputes the department's contention that the tax court did not squarely decide whether the convention center is especial use property under OAR 150-308.205-(A)(3), quoting excerpts from the court's opinion. But the first two excerpts (ER 10) do not come to any definitive conclusion and the last excerpt (ER 26) is not from the tax court's decision but from the court's order granting attorney fees. Even if the tax court decision had concluded that the convention center is not especial use property, the department's argument to the contrary was not objectively unreasonable because Exhibits 28 and 29, and testimony cited above, show that the convention center was "designed" and "used as part of a larger total operation"—the Riverhouse Resort. OAR 150-308.205-(A)(3). A convention center property is, of course, beneficial in a general sense to employees working in it, nearby hotels, and the community at large, which could be said of many especial properties. But the use of the property as part of the Riverhouse Resort complex was uniquely beneficial to it alone. While the tax court might disagree with the department's position, this position does not lack an objectively reasonable basis as presented in the department's exhibits and testimony, given that only River's Edge can claim to

be the Riverhouse Hotel and Convention Center, aka the Riverhouse Resort including the convention center.

River's Edge contends that the department was unreasonable in refusing to settle at the value later determined by the tax court and that attorney fees are therefore recoverable. It is certainly true that the department did not agree to settle the case at that amount. However, the settlement offer made by the department on December 8, 2012, was for all open tax years, 2008 through 2012, and although it started higher for 2008 the offer was for lesser amounts in subsequent years and $7.5 million in the last two years. It was not objectively unreasonable for the department to think that River's Edge would want to recover this much and more to "justly compensate [it] for loss of the property," which is the valuation standard codified at ORS 308.205(2)(c).

The department responded previously in this brief to River's Edge's argument regarding the department's appraiser's determination that only the cost approach was appropriate for the subject property. In sum, the department's appraiser was objectively reasonable in concluding that the maximally productive legally permissible use of the property was a continuation of its existing use in connection with the Riverhouse hotel, as part of the Riverhouse Resort, and commingled income and expenses could not be used appropriately in an income approach. This left the cost approach, which is a well-accepted appraisal approach for newly

constructed property such as the property at issue in this case. *The Appraisal of Real Estate* at 63.

D. Conclusion

The department respectfully requests this court to correct the errors and reverse the tax court's decision.

Dated this 21st day of August, 2015.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE
WITH ORAP 5.05(2)(d)

Brief length

I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 2,911 words.

Type size

I certify that the size of this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(4)(f).

Dated this 21st day of August, 2015.

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CERTIFICATE OF SERVICE

I certify that on August 21, 2015, I directed the original APPELLANT'S REPLY BRIEF to be electronically filed with the Appellate Court Administrator, Appellate Records Section, and electronically served upon Mark G. Reinecke, Attorney for River's Edge-Respondent, and Laurie Craghead, Attorney for Deschutes County, using the court's electronic filing system.

Dated this 21st day of August, 2015.

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