New Hampshire Merrimack River Ltd. Partnership
and
Chemical Fabrics Corporation

v.

Town of Merrimack

Docket Nos.: 7609-89, 8952-90 and 11453-91 PT

DECISION

The "Taxpayers" appeal, pursuant to RSA 76:16-a, the "Town's" 1989 and 1990 assessments of $11,655,100 (land, $1,716,500; buildings, $9,938,600) and the 1991 assessment of $11,662,300 (land, $1,723,700; buildings, $9,938,600) on 701 Daniel Webster Highway, consisting of an industrial building on a 20.824 acre lot in 1989 and 1990 and on a 21.183 acre lot in 1991 (the Property). For the reasons stated below, the appeal for abatement is granted.

The Taxpayers have the burden of showing the assessments were disproportionately high or unlawful, resulting in the Taxpayers paying an unfair and disproportionate share of taxes. See RSA 76:16-a; Tax 201.04(e); Appeal of Town of Sunapee, 126 N.H. 214, 217 (1985). We find the Taxpayers carried this burden and proved disproportionality.

The Taxpayers argued the assessments were excessive because: (1) the hundred foot height of the building was originally designed for constructing turbines when the building was owned by General Electric; the height, being designed for a special purpose, is not fully utilized for the present tenant or a normal tenant;

(2) only approximately 60% of the building is used; the balance is not usable due to poor access, load constraints and poor operational flow;

(3) the sale/lease back of the Property to Thomas Flately in May of 1987 generated at market value an annual rent of $640,000 with an option for repurchase in 1993 for $5,600,000;

(4) the Town assessed the building in three sections instead of solely as an industrial building as it is used;

(5) the Town's cap rate was derived from six sales which are not entirely representative of the Property being assessed;

(6) an appraisal by Crafts Appraisal Assoc. estimated the value by the three approaches (with most reliance on the income and direct sales approaches) at $5,790,000 for 1989, $5,925,000 for 1990 and $5,190,000 for 1991; and

(7) general market data for industrial property in the Merrimack area indicated sales prices per square foot of $30.00 for 1989 and 1990 and $26.00 for 1991; however, the subject property would likely sell for less than these prices due to the access and utility of the second floor area.

The Town argued the assessments were proper because:

(1) it was based upon an income approach to value with income and expense estimates based upon market data surveyed within the Town;

(2) the value of a property as indicated by a sales/leaseback arrangement is typically less than full market value; and

(3) the Town's capitalization rate was derived by comparing the net operating incomes with the sales prices of six sales in Merrimack and is supported by national statistics for industrial property;

Board's Rulings

Based on the evidence, we find the correct assessment should be

$6,979,100 for 1989 and 1990 and $6,986,300 for 1991. In making a decision on value, the board looks at the Property's value as a whole (i.e., as land and buildings together) because this is how the market views value. However, the existing assessment process allocates the total value between land value and building value. The board has not allocated the value between land and building, and the municipality shall make this allocation in accordance with its assessing practices.

The board's analysis of the evidence falls in two general areas:
1) the sale/lease-back transactions in 1987 involving the Property; and
2) analysis of the parties' appraisals.

1987 Sale/Leaseback

Prior to May 1987, Chemical Fabrics Corporation (Chemfab) owned approximately 175 acres and the industrial building in question. In May 1987, Chemfab sold 154 undeveloped acres to Thomas J. Flately (Flately) for $4,700,000 and 20.824 acres and the building to New Hampshire Merrimack River Limited Partnership (Partnership) for $5,640,000. Chemfab simultaneously negotiated a lease of the 20.824 acres and building with Flately for a term of six years with 5-five year options for renewal. The annual rent in 1987 was $625,000 and, in the three years appealed, had escalated to approximately $640,000.

The board gives the sale and contract rent some weight in its deliberations but finds the transactions are not conclusive evidence of the Property's value for the years under appeal.

First the sale/leaseback occurred in 1987 several years before the years under appeal. The Taxpayers did not submit any conclusive evidence that the market for this type of property did not continue to appreciate to some extent until at least 1989.

Second, the board is not convinced that the allocation of value between the two parcels was influenced strictly by real estate related factors. The two sales and the lease all occurred simultaneously. While there was no evidence of any prior relationship between the grantor and the grantees, as originally inferred by the Town, there is a relationship between the grantees in that Flately is one of the partners in the Partnership. In transactions such as this where the income tax liability of the three entities is a significant consideration, the allocation of value between two properties by related parties (Flately and Partnership, in this case) at the time of the transfer does not conclusively provide an indication of market value for respective parcels. In arriving at this finding, the board is not unmindful of Chemfab's Chief Financial Officer's affidavit concerning the arms-length nature of the transfer (Exhibit TP-1 tab A2) and the 1986 Whittier appraisal

(Exhibit TP-1 tab B5); however, even this supporting evidence of the arms-length nature of the sale does not erase the doubt that the allocation of value between the parcels may have been influenced by personal rather than property related considerations which would be improper to consider for establishing value for assessment purposes. RSA 75:1; Trustees of the Phillips-Exeter Academy v. Exeter, 92 N.H. 473, 485 (1943); Stuart J. Steele et al v. Town of Allenstown, 124 N.H. 487, 491 (1984).

Appraisals Analysis

The Town performed both the cost and income approaches to value, but relied on the income approach for the assessment. The Taxpayer performed all three approaches to value in estimating market value, but also relied most heavily on the income approach in the final reconciliation of approaches.

The board finds, based upon the evidence submitted by both parties, the income approach to value provides the best estimate of value for the two years before the board. The parties differed primarily in their estimate of value in three areas: 1) the proper net operating income; 2) the proper capitalization rate; and 3) the value of any residual land not captured by the income approach.

Rental Rate

The Town applied gross rental rates of $12.65.00 per s.f. to 49,144 s.f. of office area, $5.75 per s.f. to 89,208 s.f. of manufacturing area and $2.30

to 36,840 s.f. of multi-use storage area. The gross potential income was then reduced by an estimated five percent vacancy rate. Operating expenses, estimated at $1.50 per s.f. for the office area, $.35 per s.f. for the manufacturing area and $.30 per s.f. for the multi-use storage area and an overall five percent management expense were then subtracted from the effective potential income. These rates and estimated expenses were derived from an income-and-expense survey (Exhibit TN-A) of commercial and industrial properties in Merrimack conducted by the Town during the revaluation. From these surveys, the Town established income approach "models" for average or typical rental rates for different uses. The rates applied to the Property were increased by 15 percent for the Property being superior than the average "model" for each use.

The Taxpayer applied net rental rates of $7.50 per s.f. to 36,063 s.f. of office area, $3.00 per s.f. to 94,611 s.f. of manufacturing area and $1.00 per s.f. to 41,960 s.f. of storage area. The Taxpayer concluded that no vacancy or credit loss was necessary due to Chemfab being a good corporate tenant. The Taxpayer's rental rates were derived from an analysis of 14 comparable leases of manufacturing, office and storage properties in southern New Hampshire. Because the Taxpayer's analysis dealt in net lease information, the expenses then deducted from the effective operating income were only two percent for management, two percent for reserves and one percent for miscellaneous.

The board finds that, in the analysis and correlation process of leases in an income-and-expense survey, adjustments must be made for the differing aspects of the improvements and the terms of the leases See Encyclopedia of Real Estate Appraising 496 3rd ed. (1978). Just as adjustments in the comparable sales approach are critical in arriving at a reasonable value, such adjustments are also critical in the income approach.

The Town made no adjustments for amount of leasable area of the subject versus those in the survey nor for the inclusion of normal office area in the manufacturing rate. Most of the office leases in the Town's survey were for spaces significantly smaller than the Taxpayer's Property. Those office leases of larger space were $6.00 to $8.00 per s.f. net, supportive of the Taxpayer's estimate of $7.50 per s.f. The Town's manufacturing net rental rates (inclusive of the associated office areas) for similar sized property were arrayed from $4.00 to $5.50 per s.f. This wide range of indicated rents for large single tenant buildings sheds doubt on whether the Town properly verified and analyzed the survey returns (e.g. the Town calculated the Chemfab rent rate on the survey incorrectly at $5.46 per s.f. rather than $4.15 per s.f. based on an incorrect estimate of leasable area) and made adjustments for the differing uses and finished areas in the buildings. Therefore, the board places little weight on the gross rental conclusions of the Town, but does consider the Town's survey data in its deliberations.

The Taxpayer did analyze and consider the differing building size, use, quality and condition in arriving at its final square foot rates. Therefore, the board gives weight to the Taxpayer's appraisals (Exhibits TP-3, TP-4 and TP-5) rent estimates for the three years in question.

The board finds the Taxpayer's estimates of the leasable square footage suited for manufacturing, office and storage uses to be the best evidence. A review of the depositions (part of Exhibit TP-1) shows the Town was uncertain as to how their s.f. estimates were determined. The Taxpayers presented a floor plan as the basis of their estimates.

The board finds the building does have some obsolescence due to its height and accessibility to the upper floors which will be reflected in the board's finding of the proper rental rates that follows. However, in reaching this finding, the board also notes that 53,000 s.f. of unused areas were touted by Chemfab in their 1989 annual report as "available for expansion". Chemical Fabrics Corporation - 1989 Annual Report pg. 9.

Therefore, the board finds, based on the size, height, layout and utility of the Property in question, that the proper net lease rates should be $4.00 per s.f. for manufacturing, $7.50 per s.f. for office and $1.50 per s.f. for storage. The board finds it is not necessary to make an allowance for vacancy or credit loss because the tenant is financially reputable, has a long term lease and is a tenant by the devise of the sale/leaseback arrangement intended to liquidate capital. Further as these rates are based largely on net leases of large single tenant occupied buildings, the board finds the effective net income needs to be reduced only by an estimate of five percent for management, capital reserves and contingency expenses.

Capitalization Rate

The Taxpayer estimated overall capitalization rates at 10.50 percent for 1989 and 10.25 percent for 1990 and 1991.

The Town derived its capitalization rate by the overall rate or market-extraction method. Using six non-residential properties that sold in 1986 through 1988, the Town compared the net operating income of these properties with the properties' adjusted sale prices. The Town derived a "model" 10 percent capitalization rate for industrial type property but reduced the rate on the Property to 9 percent due to the lower risk of the single long-term corporate tenant.

While in theory it is possible to derive an overall capitalization rate from sales data, in practice the Town's methodology was flawed because the Town did not stratify or adequately adjust the sales for differing factors such as risk, land-to-improvement ratios, remaining economic life, and date and terms of sales. One book on this issue, International Association of Assessing Officers, Property Appraisal and Assessment Administration, 270 -

272 (1990), -- states:

> Capitalization rates change over time, especially with changing interest rates and changing supply and demand conditions. An overall rate of return can quickly become obsolete. Consequently, appraisers monitor capitalization rates in times of changing market conditions so that as of the date of appraisal the correct rate will be used. This can be done by adjusting available sales for sale date and terms of sale if sales close to the appraisal date are not available.

The Town adjusted the 1986 sales upwards because of an increasing market. The Town, however, did not adjust the 1987 and 1988 sales based on the premiss that the market had leveled off in 1987 and 1988. The years under appeal, however, are 1989, 1990 and 1991. It is the board's experience that the market perceptions and decisions being made by investors of income-producing property in 1986 through 1988 were quite different than those in 1989 through 1991. The 1986 through 1988 purchasers of commercial/industrial properties perceived the potential for speculative short-term appreciation coupled with good cash flow due to high occupancy rates. By 1989 and later, however, the roller coaster ride of the market for commercial/industrial properties was just past its apex and dropping with increasing vacancy rates, financing uncertainties and an oversupply of rental space. The two time periods were not entirely comparable, and, thus, adjustments should have been made to recognize this increased uncertainty and risk.

Based on the evidence the board, finds the appropriate cap rate to be 10.00 percent. In reaching this conslusion, the board weighed the long-term low risk nature of the tenant, the location of the property and the utility of the building. The board finds no need to adjust the cap rate and the rental rates for 1990 and 1991, as done by the Taxpayer, since the change in the Town's overall equalization ratio for 1990 and 1991 adequately reflects the declining value of the Property.

Residual Land

After estimating the Property's value by the income approach, the Town added $500,000 for 5 acres of "secondary" land and $216,480 for 10.824 acres of "undeveloped" land in 1989 and 1990 and $223,700 for 11.183 acres of "undeveloped" land in 1991. The Taxpayer's appraisal, specifically the income approach, did not add any value for any residual land. The board finds that the development patterns of commercial/industrial property in Merrimack indicate the present most economically feasible use of the developed portion of the parcel is in support of the existing improvements. However, since the estimated 10.824 undeveloped acres (11.183 acres in 1991) hold the potential for expansion and since their value is not captured by the income capitalization of the developed and improved portions of the property, the board finds it is reasonable to add the Town's $216,500 (1989 and 1990) and $223,700 (1991) value for the undeveloped acreage to valuation of the improved areas by the income approach.

Conclusion

In summary the board finds the proper value of the Property calculated as follows:

Net Potential Income		
manufacturing: 94,611 s.f. x $4.00 per s.f.		$378,444
office: 36,063 s.f. x $7.50 per s.f.		$270,472
storage: 41,960 s.f. x $1.50		$62,940
	Total	$711,856
Vacancy 0 %		x 1.00
Effective Net Income		$711,856
Management, Capital Reserves and Contingencies - 5 %		x.95
Net Operating Income		$676,263
Capitalization Rate 10.00 %		÷ .1000
Value of Developed Portion		$6,762,600
Value of Residual Land - 1989 & 1990		$216,500
Value of Residual Land - 1991		$223,700
Total Value - 1989 & 1990		**$6,979,100**
Total Value - 1991		**$6,986,300**

If the taxes have been paid, the amount paid on the value in excess of $6,979,100 for 1989 and 1990 and $6,986,300 for 1991 shall be refunded with interest at six percent per annum from date paid to refund date. RSA 76:17-a.

Motions for reconsideration of this decision must be filed within twenty (20) days of the clerk's date below, not the date received. RSA 541:3. The motion must state with specificity the reasons supporting the request, but generally new evidence will not be accepted. Filing this motion is a prerequisite for appealing to the supreme court. RSA 541:6.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

George Twigg, III, Chairman

Paul B. Franklin, Member

CERTIFICATION

I hereby certify a copy of the foregoing decision has been mailed this date, postage prepaid, to Peter D. Wenger, Esq., Representative for the Taxpayer; Laurence F. Kelly, Representative for the Town of Merrimack; and Chairman, Board of Assessors of Merrimack.

Dated:March 8, 1993

Valerie B. Lanigan, Clerk

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