

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89 and 9832-90

DECISION

The "Taxpayer" appeals, pursuant to RSA 76:16-a, the "Town's" 1989 and 1990 assessments of:

<u>Map/Lot #</u>	<u>Land Assessment</u>	<u>Building Assessment</u>	<u>Total Assessment</u>
2D/032-1	\$125,700	\$ 5,500	\$ 131,200
2D/032	\$877,500	\$5,763,200	\$6,640,700

(the Property). For the reasons stated below, the appeal for abatement is granted.

The Taxpayer has the burden of showing the assessments were disproportionately high or unlawful, resulting in the Taxpayer 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 Taxpayer carried this burden and proved disproportionality.

The Taxpayer argued the assessments were excessive because:

(1) the land is fully developed according to zoning and thus has no expansion potential;

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 2

(2) the 20,000 square foot area has three 10 foot high floors that fulfill the present tenant's needs but is a superadequacy for the general warehousing market;

(3) the second and third floors cannot be fully used due to inadequate construction and load capabilities; and

(4) an appraisal by Property Tax Research Co. estimated the Property's market value at \$3,990,000 for 1989 and \$3,720,000 for 1990.

The Town argued the assessments were proper because:

(1) the Property was appraised by the income approach based upon income and expense data derived from the Merrimack market; and

(2) the gross rents were increased 5% to account for the increased utility of the 30 foot high building area and the good condition of the Property.

Board's Rulings

Based on the evidence, we find the correct assessment should be \$4,649,200. 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

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 3

this allocation in accordance with its assessing practices.

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 rental rate; 2) the proper capitalization rate; and 3) the value of any residual land not captured by the income approach.

Rental Rate

The Town applied a gross rental rate of \$11.55 per s.f. to the office/areas and a gross rate of \$5.25 per s.f. to the warehouse areas. 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 and \$.35 per s.f. for the warehouse 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. The Town's "model" rates for office and warehouse were determined to be \$11.00 and \$5.00. The Town testified the rates, in this case, were increased by five percent to account for the greater utility of the 10 foot ceiling heights in 60,000 s.f. of the warehousing area.

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 4

The Taxpayer applied a net rental rate of \$3.50 per s.f. to the office and high span (20 - 30 feet) warehousing areas (82,940 s.f.) and a net rental rate of \$3.25 per s.f. to the 60,000 s.f. warehousing areas with 10 foot height. The Taxpayer testified the 10 foot ceiling height, while accommodating the current owner's need for storage of small parts, would likely be considered a superadequacy in the general warehouse market. The Taxpayer also estimated the vacancy rate at five percent. The Taxpayer's rental rates were derived from an analysis of four comparable leases and three listings of manufacturing and office 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 five percent for management, three percent for reserves and two percent for contingencies.

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

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 5

warehousing rate. Most of the warehousing leases in the Town's survey were for spaces significantly smaller than the Taxpayer's Property. In this case where the office space is less than four percent of the building's total s.f., the board finds it is reasonable to estimate the net potential income based on one rental rate for the entire building because that is how this type of property is marketed. Therefore, because the Town failed to adjust for size and the inclusion of some office space in the lease rates, the board places little weight on the Town's conclusions.

The Taxpayer did consider the differing building size, quality and condition in arriving at its final square foot rates. While there is general merit to the Town's argument that use of comparable properties outside Merrimack and its general market area is risky due to differing tax rates and locational influences, the board does not find those factors significant enough in the properties presented in this case to discredit their use.

Therefore, the board finds, based on the size and condition of the Property in question and a review of the market leases submitted by both parties, that a net lease rate of \$4.00 per s.f. for warehouse and office areas is reasonable. This rate attributes no premium or discount for the 10 foot floor area because the board finds that the current owner/tenant's needs and uses do not differ significantly from the general market. Further, this

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 6

rate recognizes the Property's size, age and condition.

Based on the evidence, a vacancy rate of five percent is found to be reasonable. 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 eight percent for management, capital reserves and contingency expenses.

Capitalization Rate

The Taxpayer estimated capitalization rates by the mortgage-equity technique at 10.88 percent for 1989 and 11.16 percent for 1990.

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.

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

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 7

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 and 1990. 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 and 1990. The 1986 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 1990, 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. If the proper adjustments had been made, the indicated overall rate would have been more akin to the cap rate derived by

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 8

the Taxpayer through the mortgage-equity method.

The board, therefore, finds the best estimate of the appropriate cap rate to be 10.88 percent. The board finds no need to adjust the cap rate and the vacancy rate for 1990, as done by the Taxpayer, since the change in the Town's overall equalization ratio from 100 percent in 1989 to 105 percent in 1990 adequately reflects the declining value for the Property.

Residual Land

After estimating the Property's value by the income approach, the Town added \$127,500 for 1.7 acres of secondary "residual" land on parcel map 2D lot 32. While the lot may have some minimal potential for further development or expansion of the existing improvements, the board finds that the development patterns of commercial/industrial property in Merrimack indicate the present most economically feasible use of this parcel is in support of the existing improvements. Therefore, the board finds the income approach accounts for the full economic potential of parcel 2D/032.

However, parcel 2D/032-1 abutting the main parcel, is fenced and used for pipe and equipment storage. The value of this parcel, while it should be considered as an integral part of the larger parcel, is not necessarily captured by the income capitalization of the improvements on parcel 2D/032 since it is put to additional use. While the Town discounted the primary site

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 9

value of parcel 2D/032-1 by 40 percent to recognize it as an economic part of the larger parcel, the board finds it is unlikely this parcel could be separately developed or transferred due to its small size. See RSA 75:9.

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 10

This parcel should be valued as if part of the larger parcel having a value akin to secondary land.

Conclusion

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

Parcel 2D/032

Net Potential Income:

warehousing and office: 142,940 s.f. x \$4.00 per s.f. \$571,760

Vacancy: - 5% x.95

Effective Net Income: \$543,172

Management, Capital Reserves and Contingencies: - 8% x.92

Net Operating Income: \$499,718

Capitalization Rate: 10.88 % ÷ .1088

Market Value **\$4,593,000**
(rounded)

Parcel 2D/032-1

Secondary Land: .676 acres x \$75,000 **\$50,700**

Improvements: Chainlink fence \$5,500

Total Value **\$4,649,200**

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 11

If the taxes have been paid, the amount paid on the value in excess of \$4,649,200 shall be refunded with interest at six percent per annum from date paid to refund date. RSA 76:17-a.

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 Property Tax Research Company and Ellen M. Hutchinson, Esq., Representatives for the Taxpayer; Laurence Kelly, Esq., Representative for the Town; and Office of the Assessor of Merrimack.

Dated: February 12, 1993

Valerie B. Lanigan, Clerk

Pope & Southwick

v.

Town of Merrimack

Docket No.: 7776-89

Page 12

0008