Omni Spectra, Inc.

v.

Town of Merrimack

Docket No.: 7780-89 & 9835-90

DECISION

The "Taxpayer" appeals, pursuant to RSA 76:16-a, the "Town's" 1989 and 1990 assessments of $6,677,100 (land, $1,675,000; buildings, $5,002,100) on Map 3C/099, a 9.9 acre lot with an industrial building. The property consists of a 88,446 square-foot (s.q.) industrial building with 42,973 s.q. used for office and laboratories and 45,473 s.q. used for manufacturing and assembly. (the Property). For the reasons stated below, the appeal for abatement is granted.

The Taxpayer has the burden of showing the assessment was 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 assessment was excessive because:
(1) an appraisal by Property Tax Research Co. estimated the market value at $4,440,000 for 1989 and $4,135,000 for 1990 based on the direct sales and

income approaches to value;

(2) the shape of the lot and the location of the existing building precludes any substantial additional development;

(3) the quality of the office space is only average;

(4) the manufacturing space is simple with tile floor, painted masonry walls and open ceiling areas; and

(5) the leases and sales relied upon by the Town were for properties all smaller than the Taxpayer's Property.

The Town argued the assessment was proper because:

(1) other industrial property in the neighborhood are assessed similarly (generally in the $71 to $79 range) while the warehousing properties in the area are in the $51 range;

(2) the Taxpayer's comparables are mostly outside of the Merrimack market; there were plenty of sales and leases within the Nashua and Merrimack market that could have been used as comparables due to the tremendous growth in the mid 1980s;

(3) the Taxpayer's leases do not correspond to the same communities as the sales data was drawn from;

(4) the assessment was derived by the income approach to value with the income and expense estimates based upon a survey of income and expense information of property in Merrimack; and

(6) the "model" lease rates, vacancy rates and cap rates were applied consistently to all similar property with a 15% latitude given the appraiser to adjust for property specific differences.

Board's Rulings

Based on the evidence, we find the correct assessment should be $4,415,500. 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 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 $11.00 per s.f. to the office/laboratory areas and a gross rate of $5.00 per s.f. to the manufacturing 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 manufacturing 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 Taxpayer applied a net rental rate of $7.50 per s.f. to the office/laboratory areas and a net rental rate of $5.00 per s.f. to the manufacturing areas. The Taxpayer also estimated the vacancy rate at five percent. The Taxpayer's rental rates were derived from an analysis of 12 comparable leases 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 manufacturing rate. Most of the office leases in the Town's survey were for spaces significantly smaller than the Taxpayer's Property. The several 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. Therefore, the board places little weight on the gross rental conclusions of the Town.

The Taxpayer did analyze and 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, that the proper net lease rates should be $5.00 per s.f. for manufacturing and $7.50 per s.f. for office with a vacancy rate of five percent. 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 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 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-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 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 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 of the Property.

Residual Land

After estimating the Property's value by the income approach, the Town added $550,000 for 4.4 acres of "residual" land. While the lot may have some 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 the entire parcel is in support of the existing improvements. Further, the Taxpayer testified that most of the land was needed for parking area due to the large percentage of office area of the building. Therefore, the board finds the income approach accounts for the present economic potential of the whole property.

Conclusion

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

Net Potential Income		
manufacturing: 45,473 s.f. x $5.00 per s.f.		$227,365
office: 42,973 s.f. x $7.50 per s.f.		$322,297
	Total	$549,662
Vacancy - 5%		x.95
Effective Net Income		$522,179
Management, Capital Reserves and Contingencies - 8%		x.92
Net Operating Income		$480,405
Capitalization Rate 10.88 %		÷ .1088
Market Value		**$4,415,500**

If the taxes have been paid, the amount paid on the value in excess of $4,415,500 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 22, 1993

Valerie B. Lanigan, Clerk

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