Hodges Properties, Inc.

v.

City of Concord

Docket Nos.: 9246-90, 11447-91PT and 13146-92PT

DECISION

The "Taxpayer" appeals, pursuant to RSA 76:16-a, the "City's" 1990, 1991 and 1992 assessments on a 42.97-acre lot containing 384 units in 16 apartment buildings known as the Alton Woods Apartments (the Property). The Property's assessments are outlined below:

Tax Year 1990 - $14,418,400;
Tax Year 1991 - $14,416,800; and
Tax Year 1992 - $13,363,700.

The Taxpayer also owned, but did not appeal, a recreational amenities complex shared with an associated development known as Canterbury Meadows identified as Map 111C-1-95 and Map 111C-1-94. For the reasons stated below, the appeals for abatements are 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 203.09(a); Appeal of Town of Sunapee, 126 N.H. 214, 217 (1985). We find the Taxpayer carried this burden and proved disproportionality.

The hearing for this Property and the related property under a separate decision owned by Hodges Development Corp. took place over three days and included extensive testimony by both parties and a view of the Property by the board.

PARTIES' STIPULATIONS AND ARGUMENTS

At the hearing, the parties stipulated to the department of revenue administration's equalization ratio for the three tax years in question. Those ratios stipulated to are:

1990 = 100%;
1991 = 108%; and
1992 = 120%.

The parties agreed that the board's findings of market value for the Property would be equalized by these ratios to result in assessments proportionate to the general level of assessment within the City during those years.

The details of the Taxpayer's arguments are contained in the various exhibits submitted at the hearing. In summary, based on appraisals performed by Craft Appraisal Associates, the Taxpayer argued the Property had market values of:

1990 = $10,750,000;
1991 = $ 9,030,000; and
1992 = $ 9,250,000.

The City did not present evidence to defend the actual assessments, but rather submitted an appraisal report for the three years which concluded the market values of the Property to be:

1990 = $14,500,000;
1991 = $12,200,000; and
1992 = $11,700,000.

BOARD'S FINDINGS AND RULINGS

General Discussion

The hearings took place over three days and voluminous evidence and documents were submitted, filling three file boxes.[1] The board's decision will be the opposite, as succinct as possible and yet meet the requirement of adequate findings of fact. The board has thoroughly reviewed the appraisals and associated documents. The board will not comment or rule on every conflicting issue raised in the parties' arguments. However, the board will make findings as to the important issues that will lead to the proper valuation conclusion for each tax year and give its reasoning as to its various findings. The board's decision will be similar to reading a map; it will not describe all the roads not taken, only those that are.

Issues

The following issues must be addressed to decide this case:

1) what is the appropriate approach to value; and

2) once the proper approach is chosen, what market-value conclusions are arrived at for the three respective years.

In summary, we decide the income approach is the most appropriate valuation approach and the findings of market value and assessments are as

---

[1] Appears there is a direct relationship between days of hearing and file boxes of evidence submitted.

follows.

	1990	1991	1992
Market Value	$12,341,300	$10,618,500	$ 9,804,500
Assessed Value	$12,341,300	$11,468,000	$11,765,400

Appropriate Approach

There are three approaches to value: 1) the cost approach; 2) the comparable-sales approach; and 3) the income approach. Appraisal Institute, The Appraisal of Real Estate at 71 (10th Ed. 1991); International Association of Assessing Officials, Property Assessment Valuation at 38 (1977).

While there are three approaches to value, not all three approaches are of equal import in every situation. The Appraisal of Real Estate at 72; Property Assessment Valuation at 38. In New Hampshire, the supreme court has recognized that no single method is controlling in all cases, Demoulas v. Town of Salem, 116 N.H. 775, 780 (1976), and the tribunal that is reviewing valuation is authorized to select any one of the valuation approaches based on the evidence. Brickman v. City of Manchester, 119 N.H. 919, 920 (1979). Given the evidence in this appeal, we find the income approach is the most appropriate approach to value because:

1) due to the lack of land sales and the difficulty in quantifying adequate physical, functional and economic depreciation, the cost approach was not employed by either party;

2) the comparable-sales approach, while given some weight by the City for 1990 and by the Taxpayer for 1990 and 1991, is not a reliable approach in this

appeal because the sales that occurred during the three years in question were not valid market indicators because most of them were related to bank foreclosures, bankruptcies, or other distressed liquidation and resale activity; and

3) the Property is an income-producing property that "is typically purchased as an investment, and from an investor's point of view, earning power is the critical element affecting property value." The Appraisal of Real Estate at 409.

Having determined the most appropriate approach is the income approach, the board must now address the following components of that approach to arrive at the proper valuation conclusion:

1) the potential gross income, including miscellaneous income of the Property;

2) vacancy and credit loss estimates;

3) appropriate expense deductions; and

4) the appropriate capitalization rate.

Potential Gross Income

The board finds the City's testimony of potential gross income to be the best evidence for the following reasons:

1) both parties were very similar as to their estimates of market rents and the resulting gross income related to the rental of the apartments;

2) the City's methodology of including the income from the laundry is

appropriate because it recognizes the income is principally generated due to the real estate location of the washers and dryers rather than by the personal property itself. Further, the City properly deducted the value of the washers and dryers in the laundry and the refrigerators and stoves in the units by deducting their depreciated replacement costs from the overall indicated value after capitalizing the net operating income.

The board finds the potential gross income for the three years to be as follows:

1990 = $2,745,360;
1991 = $2,609,040; and
1992 = $2,554,560.

Vacancy and Credit Loss

The board finds the appropriate vacancy and credit loss percentages to be as follows:

1990 = 15%;
1991 = 17.5%; and
1992 = 20%.

The board finds the City's estimate of 10%, 15% and 15% consecutively for the three years to be overly optimistic in light of the rental history of the Property itself and the general economic times for the three years in question. The board finds that, based on the extensive testimony given by Mr. Johnson, property manager for the Taxpayer, the Property was well managed and the units were aggressively marketed for rent, including enticement of free first month's rent and other incentives. The board finds that these estimated vacancy rates are reasonable given the Property's history and given the oversupply of rental units in the Concord area during these years. See Taxpayer's Exhibit 7; The Appraisal of Real Estate at 410 (as demand for units decrease and supply increases, vacancy rates increase).

Further, the City's vacancy rate estimates were based on interviews of three property management companies in the Concord area. However, testimony indicated that the style and size of the properties managed by these companies were different enough to conceivably result in vacancy rates not comparable to the Property.

Appropriate Expense Ratio

The board extensively reviewed the various components of the parties' estimates of expenses (property management, insurance, advertising, utilities, maintenance, repairs, reserves for replacement and miscellaneous) and finds the parties differed primarily in three of those areas: maintenance and repairs, reserves for replacements and miscellaneous. The largest difference appeared to be in what was an appropriate expense for maintenance and repairs. The board finds competent yet conflicting evidence presented by the parties on this issue. For example, the Taxpayer argued convincingly that the Property had a higher than normal expense for maintenance due to the large, campus-style layout and due to several years of deferred maintenance. Contrary to this, the City based their estimates on maintenance levels of similar property and also noted that an average combination of maintenance and replacement for reserves expenses of five properties the Taxpayer submitted as comparables supported the City's estimated percentages.

The Taxpayer's appraiser filed a separate report attempting to account for the additional expenses associated with the amenities building shared by Alton Woods Phase III and Canterbury Meadows. The Taxpayer stated these additional costs were not accounted for in the original pro forma expense ratio and should be capitalized and further reduce the indicated market value of Alton Woods. The gross potential income already found by the board conceivably includes any positive affect of the amenities building on the rental stream. Conversely, therefore, any reasonable estimate of expenses

related to the maintenance of those shared amenities should be considered in an appropriate expense ratio. Consequently, the board, in calculating the Taxpayer's actual expense ratio, has added 3/4 of a percent to that ratio. (The actual expenses for the shared amenities complex equates to approximately 3/4 of a percent of the effective gross income over the three years under appeal.)

Given the conflicting yet competent evidence submitted, the board gives equal weight to both parties' estimates and finds the expense ratios to be as follows:

1990 = 30.88% of effective gross income;
1991 = 32.38% of effective gross income; and
1992 = 32.88% of effective gross income.

When confronted with conflicting evidence, it is reasonable for the board to compromise as to the expense ratio conclusion. See Rollsworth Tri City Trust v. City of Somersworth, 126 N.H. 333, 338 (1985). In arriving at findings of fact that do not exactly correspond to either party's evidence, but are within the parameters of the conflicting evidence submitted, the board merely employs its statutorily countenanced ability to utilize its "experience, technical competence and specialized knowledge" in evaluating the evidence before it. See RSA 541-A:18, V(b); Appeal of City of Nashua, N.H. ___ (March 3, 1994).

Capitalization (Cap) Rate

This section will begin with a brief discussion of the two principal methods for developing a capitalization rate: 1) direct capitalization from the market; and 2) yield capitalization (more specifically in this case, the mortgage-equity technique).

Direct capitalization involves the development of an overall capitalization rate by analyzing "actual ratios of income to sales price of properties similar to the one being appraised." The International Association of Assessing Officers, Property Appraisal and Assessment Administration at 269 (1990). Generally, the board finds direct capitalization is the more preferred method where there exists qualified market sales comparable to the property being appraised. However, those conditions do not exist in this case. Consequently, the board considers but gives little weight to the overall cap rate conclusions by the Taxpayer and the City. The very sales the Taxpayer used to derive its overall rate were the sales the board has rejected in its direct market comparison approach as not being reflective of market value due to the sales being related to liquidation of bank portfolios. The sales the City relies on for its overall rate are sales that all occurred in

1989, and thus, are conceivably not comparable to the market period under appeal in this case because of the change in market for apartment complexes.

> 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. Property Appraisal and Assessment Administration at 272.

The mortgage-equity technique of yield capitalization is a method that attempts "to simulate investor's decision making processes." Id. at 272. In attempting to simulate the investor's decision-making process, the

appraiser analyzes market data relative to investment and, after making certain assumptions, develops a cap rate that encapsulates all those various factors. The mortgage-equity technique is comprised of the following components:

1) the mortgage interest rate;

2) the equity yield rate;

3) the mortgage term;

4) the holding period for the property;

5) the loan-to-value ratio; and

6) the appreciation of the property over the holding period.

The board will briefly discuss each one of these components, find the appropriate factor, and thereby develop the indicated capitalization rate to be applied to the net operating income for each of the three years.

1) Mortgage Interest Rates.

Both parties surveyed the market and found nearly identical mortgage interest rates for the three years in question. Reviewing the market survey information presented by both parties, the board concludes the City's rates of 10% for 1990, 9.5% for both 1991 and 1992 are reasonable and, if anything, are slightly to the advantage of the Taxpayer.

2) Equity Yield Rate.

The Taxpayer chose an equity yield rate of 15% while the City chose an equity yield rate of 12%. The board finds that an equity yield rate of 15% for all three years is reasonable. This higher equity yield rate is

appropriate for the Property because during the three years in question, larger apartment complexes were not as desirable as some safer investments. Given the inherent higher risk and uncertainty of a profitable return when investing in the apartment complexes, a higher equity yield rate is appropriate.

3) Mortgage Term.

The Taxpayer indicated a term of 20 years while the City indicated a term of 25 years. Again, a review of the parties' market survey information indicates a 25-year mortgage term is appropriate for the Property.

4) Holding Period.

The Taxpayer indicated a 5-year holding period while the City estimated a 10-year holding period. The board finds a 10-year holding period is reasonable due to the expectations an investor would have when purchasing the Property during the volatile market years. In the mid to late 1980's, one might have assumed a shorter holding period due to indications from the market of the constant resale or flipping of such properties. However, that was most definitely not the market in the three years under appeal. Further, a review of the market information presented by both parties supported the 10-year holding period conclusion.

5) Loan-to-Value Ratio.

The Taxpayer estimated a loan-to-value ratio of 70% for 1990, 60% for 1991, and 75% for 1992, while the City estimated a constant ratio of 70% for the three years. The board finds that a loan-to-value ratio of 70% for the

three years is reasonable. The fluctuating loan-to-value ratio presented by the Taxpayer does not appear to reflect either the general market information supplied to the board by the parties nor does it seem reasonable given the economic climate and lending difficulties for properties such as the subject.

6) Appreciation.

The Taxpayer assumed no appreciation over the holding period for the three years under appeal. The City assumed a 15% appreciation over a 10-year holding period for 1990 and 0% appreciation for 1991 and 1992. The board finds the City's estimates of appreciation were reasonable. An investor, as of April 1, 1990, would have had only hindsight available to estimate what possible appreciation would occur in the Property during the next 10 years. As of April 1, 1990, while the market evidence from 1988 and 1989 indicated a leveling off, there was no precipitous drop at that point in time nor evidence of the long-term uncertainty that pervaded the market in the following years. Therefore, an assumption of an annual appreciation of 1.5% at that point in time would have been reasonable. The subsequent difficulties in the real estate market in general, and in particular apartment complexes, and the general shake up of the lending institutions in the northeast would have abated any expectation of appreciation by April, 1991 and April, 1992.

Conclusion of Cap Rate

Based on the above findings, the board has calculated a mortgage constant for each year, adjusted the mortgage constant for equity buildup and appreciation, and added the respective year's tax rate to arrive at the following capitalization rates for the three years in question:

1990 = 13.40%;
1991 = 14.09%; and
1992 = 14.45%.

CALCULATION OF MARKET VALUES AND ASSESSMENTS

Based on all the above findings, the board finds the market values by the income approach and assessments are calculated as follows.

	1990	1991	1992
Potential Gross Income	$ 2,745,360	$ 2,609,040	$ 2,554,560
Vacancy & Credit Loss	(15.0%) $ (411,804) $ 2,333,556	(17.5%) $ (456,582) $ 2,152,458	(20.0%) $ (510,912) $ 2,043,648
Carport & Laundry Income	$ 101,932	$ 96,708	$ 95,046
Effective Gross Income	$ 2,435,488	$ 2,249,166	$ 2,138,694
Expense Ratio	(30.88%) $ (752,079)	(32.38%) $ (728,280)	(32.88%) $ (703,203)

Net Operating Income	$ 1,683,409	$ 1,520,886	$ 1,435,491
Capitalization Rate	.1340	.1409	.1445
Indicated Value	$12,562,753	$10,794,080	$ 9,934,194
Less Personal Property	$ (221,445)	$ (175,560)	$ (129,675)
MARKET VALUE *	$12,341,300	$10,618,500	$ 9,804,500
Equalization Ratio	(100%) x 1.00	(108%) x 1.08	(120%) x 1.20
ASSESSED VALUE *	$12,341,300	$11,468,000	$11,765,400

***** the market values and assessed values are rounded to the nearest fifty

REFUND

If the taxes have been paid, the amount paid on the value in excess of the assessments listed above shall be refunded with interest at six percent per annum from date paid to refund date. RSA 76:17-a. Pursuant to RSA 76:17-c II, and board rule TAX 203.05, the City shall also refund any

overpayment for 1993. Until the City undergoes a general reassessment, the City shall use the ordered assessment for subsequent years with good-faith adjustments under RSA 75:8. RSA 76:17-c I.

REHEARING PROCEDURE

A motion for rehearing, reconsideration or clarification (collectively "rehearing motion") of this decision must be filed within twenty (20) days of the clerk's date below, not the date this decision is received. RSA 541:3; TAX 201.37. The rehearing motion must state with specificity all of the reasons supporting the request. RSA 541:4; TAX 201.37(b). A rehearing motion is granted only if the moving party establishes: 1) the decision needs clarification; or 2) based on the evidence and arguments submitted to the board, the board's decision was erroneous in fact or law. Thus, new evidence and new arguments are only allowed in very limited circumstances as stated in board rule TAX 201.37(e). Filing a rehearing motion is a prerequisite for appealing to the supreme court, and the grounds on appeal are limited to those stated in the rehearing motion. RSA 541:6.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

____
Paul B. Franklin, Member

____
Ignatius MacLellan, Esq., Member

____
Michele E. LeBrun, Member

CERTIFICATION

I hereby certify a copy of the foregoing decision has been mailed this date, postage prepaid, to Peter D. Wenger, Esq., and John G. Cronin, Esq., Attorneys for Hodges Properties, Inc., Taxpayer; Alan W. Johnson, Controller for Taxpayer; Walter L. Mitchell, Esq., Attorney for the City of Concord; and Chairman, Board of Assessors for the City of Concord.

Dated:

____
Valerie B. Lanigan, Clerk

0005

Hodges Development Corporation and
Hodges Properties, Inc.

v.

City of Concord

Docket Nos.: 9245-90/11448-91PT/13145-92PT and
Docket Nos.: 9246-90PT/11447-91PT/13146-92PT

ORDER

On June 30, 1994 the board received a Motion to Enforce for Non-Compliance as to Ordered Assessment from the Taxpayer.

The board, pursuant to TAX 203.05(k), will hold a hearing on this Motion on Friday, September 9, 1994 at 9:00 a.m.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

Valerie B. Lanigan, Clerk

CERTIFICATION

I hereby certify that a copy of the foregoing order has been mailed this date, postage prepaid, to Peter D. Wenger, Esq., representative for the Taxpayer; and Paul Cavanaugh, Esq. and Michael Ryan, representing the City of Concord.

Dated: July 18, 1994 ______________________________
Valerie B. Lanigan, Clerk

0007