Boscawen Mini-Storage, Inc.

v.

Town of Boscawen

Docket No.: 14794-93PT

DECISION

The "Taxpayer" appeals, pursuant to RSA 76:16-a, the "Town's" 1993 assessment of $528,000 (land $145,400; buildings $382,600) on an 11.42-acre lot with 4 storage buildings (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 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 Taxpayer argued the assessment was excessive because:

(1) an appraisal prepared by Randolph Daniels estimated the Property's market value was $225,000;

(2) the Property was purchased in May of 1993 for $205,000;

(3) the only sales available were bank or bank influenced sales because they are what comprised the market;

(4) the capitalization rate was derived from the sales used in the sales approach and indicated a capitalization rate of 17%; and

(5) the Town's submitted discounted cash flow assumes a higher effective income than the actual income of the Property indicates.

The Town argued the assessment was proper because:

(1) the Property had the potential for expansion in 1993 (as exhibited by the additional units added in 1994 and 1995) that the Taxpayer's appraisal did not capture; and

(2) the Taxpayer's capitalization rate was based on bank distressed sales not used in the department of revenue administration's equalization ratio analysis and, thus, is not the proper basis for capitalizing the income stream.

BOARD'S RULINGS

The parties agreed the 1993 equalization ratio was 137%. Based on this ratio, the 1993 indicated market value was $385,400 for the Property ($528,000 ÷ 1.37). We find the equalized market value exceeds the Property's market value and an abatement is ordered to $448,900 (land $145,400; buildings $303,500).

The board approached its decision in two fashions: 1) we reviewed and analyzed all the evidence relative to the Property's market value by the income approach; and 2) the board revised the Town's assessment by applying a 20% economic factor to all the improvement's values.

The board's major findings that are discussed in detail are as follows: 1) the Daniels' appraisal, both in its market and income approach, improperly relied on bank sales for its indication of market value; 2) a revised estimate of value by the income approach indicates a market value finding of approximately $300,000; and 3) the Town's cost/market approach does not adequately consider the Property's income producing capability.

Daniels' Appraisal

The Daniels' appraisal used four sales (including the sale of the Property in May 1993 for $205,000) in his market approach and in deriving a direct capitalization rate in his income approach. We find all four sales were bank or bank related sales, which while affecting the general market, are not, in this case, conclusive of market value. The board has consistently held that properties sold by lending institutions at foreclosure or sales by owners to satisfy delinquent loans do not meet the definition of arm's-length transactions owing to undue pressure on the owner to sell. Mr. Daniels and the Taxpayer argue that the only sales of mini-storage properties were bank held or related sales and, thus, they define the market. The board rejects this argument because to agree with it would create a different assessment standard than is required by RSA 75:1 and a different assessment level than that applied to all other properties within the Town.

For sales to be indicative of market value, they must be arm's-length transactions. "An arm's-length transaction is `[a] transaction freely arrived at in the open market, unaffected by abnormal pressure or by the absence of normal competitive negotiation as might be true in the case of a transaction between related parties.´ B. BOYCE, REAL ESTATE APPRAISAL TERMINOLOGY 18 (REV. ED. 1984)." Appeal of Lakeshore Estates, 130 N.H. 504, 508 (1988). We find that these sales do not reflect the open market competitive negotiations that should occur for sales to be arm's length. See also Society Hill Merrimack Condominium Association & a. v. Town of Merrimack, 139 N.H. 253, 255 (1994).

All assessments must be based on market value (RSA 75:1) and be relative to the general level of assessment within the taxing jurisdiction. In 1993, Boscawen's level of assessment was 137% as determined by the department of revenue administration's (DRA) equalization ratio. This means assessments generally were 37% higher than market value. DRA's ratio was derived in 1993 based on a total of 65 sales that occurred within the Town. However, DRA in its verification process determined that 50 sales should not be included in the ratio study due to their not being arm's-length transactions or disqualified for other reasons. Many of those sales were discarded as being bank related sales or family related sales (see copy of DRA's 1993 ratio study included in Appendix A). Consequently, because the 137% ratio was determined exclusive of bank sales, it would not be appropriate to arrive at a market value indication by bank sales and then to equalize that market value finding by the Town's non-bank related ratio of 137%.[1]

[1]None of the four sales used in the Daniels' appraisal were used by DRA in any of its ratio studies for the towns in which the sales occurred. Sales #1, #2 and #4 were specifically excluded by the DRA. Sale #3 was not used due to random sampling used in Derry where only one of every three sales is considered initially. Of the three sales excluded by DRA, it is interesting to compare the assessment-to-sales ratio for each sale with the Town-wide ratio determined by DRA in each case.

Sale No.	Assessment-to-Sale Ratio	Town-wide Ratio
SS-1	2.58	1.37
SS-2	2.37	1.45
SS-4	2.13	1.28

While it is conceivable that any of the three sales (sale SS-1 is actually the Property under appeal) could be overassessed, this comparison shows in a general fashion that the properties sold for significantly less than what their equalized assessed values would have indicated.

The board not infrequently sees bank related sales included in appraisals because those are the only sales that occurred for a certain type of property. However, if bank sales are used, the appraiser should take the extra step and attempt to determine what adjustment is reasonable (more than the token 5% made by Daniels in this case) to adjust those sales to normal arm's-length conditions. The board has been presented with such studies, which indicate a great variation depending on the type of property as to what factor needs to be applied.

Because in this case no such study was performed and presented and no significant adjustment was made to the bank sales, the board gives little weight to the Daniels' value conclusion in both the market and income approach.

Revised Income Approach

In reviewing the evidence and attempting to determine an estimate of market value, the board considered the three approaches to value: 1) the cost approach; 2) the comparable-sales approach; and 3) the income approach. The Appraisal of Real Estate at 71 (10th Ed. 1991). We give most weight to the income approach based on analyzing and revising the data provided by the parties and some weight to the Town's cost approach (which will be discussed in the next section). The board gives no weight to the Daniels' market approach because as earlier discussed, it was based solely on bank related sales.

Based on the evidence in this case, we find the direct capitalization valuation technique is appropriate to use. It is conceivable a discounted cash flow analysis (which projects future income for a period of years discounting it to current value) could capture the Property's potential for expansion. However, the board finds that, due to conflicting evidence as to what was actually built in 1994 and 1995 and no evidence as to what was either legally permissible or economically feasible for expansion, the proper assumptions for those future years would be difficult to conclusively determine. Consequently, the board arrives at an indicated value by the direct capitalization valuation technique for 1993 and uses that indicated market value finding to adjust the improvements in the Town's assessment by applying economic depreciation. The land component of the assessment is not adjusted as it is assumed to inherently include the full commercial potential of the Property.

The income approach estimates market gross income for the Property, deducts vacancy and credit loss and estimated operating expenses and capitalizes the resulting net operating income to arrive at an indicated market value. The board will discuss each one of these components briefly in the following analysis.

Gross Operating Income

Both parties agreed to an estimated gross income of $115,832 based on an average market rent of $4.79 per-square foot for the rental units (as contained in the Daniels' appraisal) and $3,800 of actual income for the ice cream store. First, the board finds the Daniels' market analysis of market rents in part 3, page 14-16 to be reasonable. While the average rent of $4.79 appears to be slightly lower than the surrounding market rents, the appraiser appropriately notes the Property is located in a slightly inferior location relative to the greater Concord area and the vacancy rate has been reduced by having such a competitive rent. The only revision the board would make to the gross operating income is to increase the rent for the garage/office/ice cream store building to reflect all the storage and office areas on which no actual rent had been received. To not include an estimate of income for that area would result in placing no value on any portion of the building other than the ice cream store.

No evidence was submitted as to market rents for storage/warehouse/office type uses. However, based on the board's experience, we find that the 3,192 square feet (inclusive of the ice cream store) would have an estimated gross rent of $3.00 per-square foot, thus adding $9,576 to the gross income of the rental units. Thus, the board's revised estimate of gross operating income is $121,662 comprised of $9,576 of non-mini-storage rental area and $112,086 of mini-storage rental.

The board considered but was unable to place weight on the Taxpayer's 1994 and 1995 income tax statements for a basis of effective gross income because of the conflicting testimony by the owner as to rental rates and levels of occupancy. In any regard, an estimate of market rents, such as that performed in the Daniels' appraisal, is generally more appropriate than reliance on actual or contract rents.

<u>Vacancy and Credit Loss</u>

Based on the evidence, the board estimates a vacancy and credit loss of 25%. This estimate is based both on Daniels' and the Town's estimates and the owner's testimony (albeit conflicting at times) of the Property's history and considers the unrented space in the ice cream store building.

<u>Expenses</u>

All evidence indicates expenses can be estimated at approximately 50% of effective gross income. Both Daniels and the Town agreed to the 50% estimate for expenses and the Taxpayer's income tax returns generally support this estimate. This estimate is exclusive of property taxes, depreciation and debt service.

A summary of the board's revised net operating income is as follows:

Gross Operating Income	$121,662
Vacancy and Credit Loss (-25%)	x .75
Effective Gross Income	$ 91,246
Expenses (50%)	$ 45,623
Net Operating Income	$ 45,623.

Capitalization Rate

As stated earlier, the board finds the Daniels' direct capitalization rate to be improper because it relies on bank related sales. We find a reasonable estimate of a capitalization rate can be calculated by the mortgage equity technique despite the Property being a relatively high-risk property and the difficulty in obtaining conventional financing. Such factors can be reflected in the mortgage equity technique. The board's rate is based on the following assumptions: 1) an equity yield rate of 15%; 2) a mortgage interest rate of 10%; 3) an amortization period of 20 years; 4) a loan-to-value ratio of 40%; 5) a holding period of 7 years; 6) an annual appreciation of 1% per year; and 7) an effective tax rate of 2.8%. The indicated capitalization rate based on these assumptions is 15.2% and is detailed in Appendix B.

First, the board's most significant assumption is the loan-to-value ratio of 40%. The board agrees with the Taxpayer that obtaining conventional financing for the Property was difficult in 1993 and that the Property was generally perceived as a high-risk property by lending institutions. However, rather than assuming banks would raise their interest rate to reflect the higher risk inherent in the Property, we find it is more likely the bank would loan a lesser amount necessitating a higher percentage of owner equity in the Property. In fact, the owner of the Property testified that approximately 40% of the total purchase price was financed with the balance coming from private equity.

Second, while not significantly different, we find an equity yield rate of 15% is more reasonable relative to the nature of this Property than the 14% suggested by the Town. Also, we find the estimate of annual appreciation of 1%

is perhaps more reflective of investor's expectations in the 1993 market than the 2% estimated by the Town.

In conclusion, the indicated market value by the income approach is estimated to be approximately $300,000 (net operating income of $45,623 ÷ .152).

Revised Town Assessment

Having arrived at an estimated market value of approximately $300,000 by the income approach, the board analyzed the Town's cost/market approach in the assessment and determined that a 20% economic factor should be applied to the improvements to reflect the Property's loss in value from its cost based on its income producing ability. As stated earlier, the board finds the land value should remain the same to capture the potential for some further development of the Property. Consequently, the board finds the proper assessment is summarized as follows:

Land			$145,400
Building Values:	Card 1	$ 47,700	
	Card 2		$109,200
	Card 3		$ 80,500
	Card 4		$ 66,100
Total Assessment			$448,900.

This revised assessment, when equalized by the Town's ratio of 137%, provides an indicated market value of $327,700. We find the difference ($27,700) between the indicated market value of the revised assessment and that of the income approach reasonably accounts for the limited development potential for the Property that the income approach does not entirely capture.

If the taxes have been paid, the amount paid on the value in excess of $448,900 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, unless the Town has undergone a general reassessment, the Town shall also

refund any overpayment for 1994 and 1995. Until the Town undergoes a general reassessment, the Town shall use the ordered assessment for subsequent years with good-faith adjustments under RSA 75:8. RSA 76:17-c I. Good-faith adjustments in the subsequent years would include applying the board's finding of 20%
economic adjustment to the new buildings if the Town concludes the market conditions that existed in 1993 and as found by the board in this decision continue to exist in subsequent years.

A motion for rehearing, reconsideration or clarification (collectively "rehearing motion") of this decision must be filed within thirty (30) days of the clerk's date below, <u>not the date this decision is received</u>. 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 in 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. Generally, if the board denies the rehearing motion, an appeal to the supreme court must be filed within thirty (30) days of the date on the board's denial.

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 Eaton W. Tarbell, Jr., Esq., Counsel for Boscawen Mini- Storage, Inc., Taxpayer; and Chairman, Selectmen of Boscawen.

Dated:May 22, 1996

Valerie B. Lanigan, Clerk

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ORDER

During its deliberations, the board determined it needed clarification as to information contained in Taxpayer's Exhibits 3 and 4 (1994 and 1995 income tax return). Included with both years income tax returns was Form 4562 (copies enclosed) Depreciation and Amortization. The 1994 form indicated that $57,703 of depreciable capital improvements were added in March of 1994. Similarly, the 1995 form indicates $80,600 of capital improvements were added in May of 1995. So that the board can use these numbers and assist it in arriving at a capitalization rate, the board requests the Taxpayer to respond to the following questions:

1) Does the amount of depreciable capital improvements for each year reflect any improvements other than additional rental units added;

2) What was the additional square footage of rental units built in 1994 and 1995 that corresponds to these capital costs; and

3) Was the average rental rates for 1994 and 1995 the same as the $4.79 determined for 1993; if not, what were the average rental rates for those years for the subject Property?

The board request the Taxpayer respond to these questions within ten (10) days of the clerk's date below, copying the Town of Boscawen.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

George Twigg, III, Chairman

Paul B. Franklin, Member

CERTIFICATION

I hereby certify that a copy of the foregoing order has been mailed this date, postage prepaid, to Eaton W. Tarbell, Jr., Esq., counsel for the Taxpayer; and Chairman, Board of Selectmen.

Date: April 11, 1996

Valerie B. Lanigan, Clerk

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