

HJ Heyman Sons LLC

v.

City of Keene

Docket Nos.: 19612-02PT/20446-03PT

DECISION

The “Taxpayer” appeals, pursuant to RSA 76:16-a, the “City’s” 2002 and 2003 assessments of \$12,342,200 (land \$2,996,000; buildings \$9,346,200) and \$13,370,700 (land \$2,996,000; buildings \$10, 374,700), respectively, on a 14.98-acre lot (Parcel 060-01-001.000) located at 480 West Street and improved with a shopping center (the “Property”). For the reasons stated below, the appeal for abatement is denied.

The Taxpayer has the burden of showing, by a preponderance of the evidence, the assessment was disproportionately high or unlawful, resulting in the Taxpayer paying a disproportionate share of taxes. See RSA 76:16-a; TAX 201.27(f); TAX 203.09(a); Appeal of City of Nashua, 138 N.H. 261, 265 (1994). To establish disproportionality, the Taxpayer must show the Property’s assessment was higher than the general level of assessment in the municipality. Id. The board finds the Taxpayer failed to prove disproportionality.

The Taxpayer argued the assessment was excessive because:

- (1) the anchor tenant on the Property is K-Mart and uncertainty surrounding the time this tenant spent in bankruptcy proceedings (from January, 2002 – May, 2003) adversely affected the market value of the Property in tax years 2002 and 2003;
- (2) estimates of net operating income and a capitalization (“CAP”) rate, adjusted upwards by about 3% to take into account the “K-Mart factor,” results in a substantially lower assessment for the Property (as calculated in Taxpayer Exhibit 1, Tab M);
- (3) the City’s own expert appraiser (Duane Cowall) conceded the CAP rate should be adjusted upward because of the “K-Mart factor”;
- (4) the Cushman & Wakefield (“C & W”) appraisal commissioned by Webster Bank estimated a higher (\$13,700,000) market value, but this estimate must be discounted because the actual refinancing terms imposed by the bank, which included a personal guaranty of 50% of the amount borrowed by the principal owner (Samuel J. Heyman), were very stringent due to the additional risk caused by the “K-Mart factor”; and
- (5) the Property is entitled to a substantial abatement in each tax year.

The City argued the assessment was proper because:

- (1) the Property was purchased by the Taxpayer in June, 1998 for \$12,050,000;
- (2) the K-Mart store was totally renovated in 1995 and the Property is an attractive shopping center in a good location, which augments its market value;
- (3) the lender (Webster Bank) used by the Taxpayer obtained a full, self-contained appraisal from C & W (included as part of Municipality Exhibit 1, Tab E) estimating a high market value (\$13,700,000 as of March 12, 2004) and this appraisal considered the so-called “K-Mart factor” but concluded that only a nominal adjustment (about 0.25%) to the CAP rate was indicated;

(4) the Taxpayer's CAP rate (15.87%, revised from 16.09%) is too high and the City's calculation of CAP rates of 13% for tax year 2002 and 12% for tax year 2003 are reasonable and supported by the evidence and calculations in Municipality Exhibit A, Tab D;

(5) the City retained Duane Cowall to give a preliminary opinion of value and his estimated value range also supports the City's assessments;

(6) the possible loss of an anchor tenant to bankruptcy need not necessarily result in a lower market value: for example, the bankrupt Bradlees was a tenant in another shopping center within the City (Riverside Plaza); this center sold for \$14.25 million in 2001 and the bankrupt tenant was replaced by Wal-Mart;

(7) K-Mart continued to operate on the Property and fulfill its lease obligations, including payment of rent and maintenance charges; and

(8) the Taxpayer failed to meet its burden of proof.

The City requested costs in the amount of \$5,338 because the appeal "has been frivolously maintained" by the Taxpayer.

The parties agreed that the level of assessment in the Town was 98.6% in 2002 and 97.7% in 2003.

Board's Rulings

Based on the evidence presented, the board finds the Taxpayer failed to prove the Property was disproportionately assessed in tax years 2002 and 2003. The appeals are therefore denied, and so is the City's request for costs, for the reasons discussed below.

The board considered the lengthy submissions of both the Taxpayer and the City. The Taxpayer's presentation included a thick notebook compiled by its representative, David Irwin of Tax Choice Services, with supplemental testimony from the Taxpayer's Director of Retail Leasing

(Donna Taylor). Among other things, Mr. Irwin submitted a “chart” of ten sales of shopping centers including K-Mart stores in six states with some supporting documentation, other financial analyses of shopping centers, along with contract rent analyses and valuations using an income approach. See Taxpayer Exhibit 1 and its various tabbed items.

For its part, the City, represented by its assessor Laura J. Thibodeau, with additional testimony from a licensed appraiser (Duane Cowall), presented a considerable quantity of evidence. The City’s notebook included both a market value analysis prepared by Mr. Cowall (hereinafter the “Cowall Report”) and an appraisal prepared by Cushman & Wakefield for a lender (Webster Bank) to the Taxpayer (the “C & W Appraisal”), as well as a CAP rate computation and a summary of the City’s arguments. See Municipality Exhibit A and its various tabbed items.

Both the Taxpayer and the City agreed the income approach was the most reasonable method for determining the market value of the Property. Use of the income approach requires an estimate of stabilized net operating income (“NOI”) and application of an appropriate CAP rate. There is little relative disagreement in this appeal regarding NOI, but major differences regarding the appropriate CAP rate.

Municipality Exhibit B presents a convenient summary spreadsheet of the various estimates used by the City, Mr. Irwin, C & W and Mr. Cowall in applying the income approach. There are relatively minor differences in the net income estimates: for 2002, for example, they are within 5% of each other, ranging from \$1.535 million to \$1.604 million.¹

The big difference lies in choice of an appropriate CAP rate. In using the income approach, a higher CAP rate results in a lower market value estimate and this is quite evident in

¹ The “Irwin” numbers in the spreadsheet were compiled by the City with information it obtained from the Taxpayer’s representative just prior to the hearing. At the hearing, Mr. Irwin amended some of his income approach numbers, but none vary so significantly for the board to conclude any substantial differences underlie the parties’ NOI estimates.

Municipality Exhibit B which documents the application of various CAP rates to the NOI estimates. Mr. Irwin initially used a uniform 16.09% CAP rate for 2001, 2002 and 2003, which he corrected to 15.87% at the hearing. See Taxpayer Exhibit 1, Tab M (original and corrected pages). In contrast, everyone else (the City, C & W and Mr. Cowall) used CAP rates that are about three percentage points lower. For 2002, for example, the City used 13%, C & W used 12.21% and Mr. Cowall used 13.16%.

The key reason for this disparity in CAP rates is the so-called K-Mart factor. According to Mr. Irwin, the “shadow” of the K-Mart bankruptcy “cast a significant pall on the Property,” diminishing its market value. K-Mart filed a bankruptcy petition (for reorganization, not liquidation) in January, 2002 and then emerged from bankruptcy in May, 2003. As part of this reorganization, K-Mart closed or transferred a number of its less desirable store locations. The K-Mart on the Property, however, is a larger, more modern “Big K” store and was not slated for closing: in fact, this tenant continued to pay its full rent and other obligations throughout this period.

The board does not agree that a very large risk premium (roughly 3%) should be applied due to the “K-Mart factor.” While it is conceivable the financial uncertainties caused by a bankrupt tenant could increase the risk premium a potential buyer might place on a shopping center, the evidence failed to support the large risk premium applied by Mr. Irwin. Both C & W and Mr. Cowall considered and used much smaller risk premiums (ranging from 0.25% to no more than 1.0%) in deriving their own CAP rates. The board finds these rates are both more consistent with each other and more reasonable.

The C & W appraisal discussed the K-Mart tenant in some detail, noting the bankruptcy but indicating it was returning to profitability and becoming a “solid credit retailer,” and that, even

if K-Mart departed, because of “the location of the center, good access and local demand, this space could be leased within a reasonable time to another large tenant.” We agree with this general observation. The premium attached to the K-Mart factor by C & W was therefore quite low (in the range of 0.25%), leading to the “most probable” CAP rate of 9% and a market value estimate of \$13.9 million using the direct CAP method (and a slightly lower market value estimate of \$13.7 million using the discounted cash flow method). See Municipality Exhibit A, Tab E, C & W appraisal, pp. 59, 65-66 and 74.

Mr. Cowall, at the request of the City, prepared a “preliminary opinion of value” which acknowledge the K-Mart bankruptcy filing but noted “several factors minimized the risk” to the Property, including the fact the space was renovated by K-Mart in 1995 and that its lease rate was “below market,” both factors increasing the likelihood K-Mart would “keep this store open” or that the space could be “sub-leased by K-Mart to another ‘big box’ retailer.” Id., Cowall opinion, p. 2. As a result, Mr. Cowall testified his tax adjusted, overall CAP rates (13.16% - 13.66%) reflected a premium of only between 0.5% and 1% for the K-Mart factor. Id., p. 14.

The Taxpayer’s CAP rate (correct to just below 16%) is also less credible because it fails to adjust for falling interest rates between 2002 and 2003. In comparison, the City and C & W both applied lower CAP rates for 2003. See Municipality Exhibit B.

The board finds Mr. Irwin’s attempt to compare the real estate market for shopping centers to the stock market to be less than compelling. While some similarities do exist, it is unreasonable to assume a real estate investor would drastically revise his valuation of an existing shopping center, based on news that a tenant has filed for reorganization in bankruptcy, the way the stock market reacted to several recent announcements (Vioxx for Merck and Celebrex for Pfizer –

Mr. Irwin's examples). The board will not belabor the obvious differences except to note that investments in the national stock market are much more liquid, with correspondingly greater price volatility, than a local real estate market. In addition, shopping center tenants, even if they are "anchors," are more easily replaceable (as noted in the City's example of Bradlees replaced by Wal-Mart in the Riverside Plaza shopping center) than major products researched, tested, produced and then marketed by drug companies, with great expenditures of time and money. Therefore adverse news regarding a tenant would not be as significant as the stock market examples cited by Mr. Irwin.²

Similarly, the board finds Mr. Irwin's presentation regarding shopping centers in other parts of the country and surveys of real estate brokers and financiers to be short of the mark. Imputed CAP rates may differ for a host of reasons, including local real estate market conditions. Much of the information presented in Taxpayer Exhibit 1 regarding how the K-Mart bankruptcy might adversely have influenced shopping center selling prices is anecdotal and speculative in nature and inherently unreliable. The board further notes that unlike the preparers of the C & W Appraisal or Mr. Cowall, Mr. Irwin is not a qualified real estate appraiser, further diminishing the comparative weight that can be given to his value conclusions.

In addition, the board notes the Property was not for sale in either tax year 2002 or 2003. It was purchased in June, 1998 for \$12,050,000 by the Taxpayer, an experienced owner and manager of shopping centers. Taking into account even a modest level of appreciation would result in values that would support the assessments in each of these tax years.

² As an aside, the board notes that some amount of tenant turnover is an expected part of shopping center management. The Taxpayer had another tenant, Cherry & Webb, that leased a significant amount of space, filed for bankruptcy and closed its doors, but Mr. Irwin did not argue that this occurrence adversely impacted the market value of the Property. (Cherry & Webb is owned by CWT Specialty Stores, Inc., which filed for a reorganization in bankruptcy in March, 2000.)

The Property was refinanced for \$10.5 million with Webster Bank in 2004, with a 75% loan to market value ratio, which suggest a market value estimate of \$14 million (slightly above the C & W Appraisal estimate). See Taxpayer Exhibit 3. The board is not persuaded by Mr. Irwin's suggestions that special financing terms (such as Mr. Heyman's personal guaranty of 50% of the loan amount) reflects a lower actual valuation for the Property, rather than other factors, such as the bank's own lending policies or risks associated with the Taxpayer rather than the Property.

The basis for property tax assessment is market value, adjusted by the level of assessment in the City. RSA 75:1 and 75:8, I. In these appeals, the Taxpayer failed to prove the assessments on the Property, taking into consideration all of the evidence regarding its location, condition and other factors, were disproportional. The appeals are therefore denied.

Along with denials of the appeals, the City requested an award of costs in the amount of \$5,338. Municipality Exhibit A, Tab A, page 7. The City noted the Taxpayer was less than forthcoming in providing requested documents, including the tenant leases needed to calculate "overage rent." Municipality Exhibit A, Tab A, page 4. The City did not, however, apparently seek formal discovery from the Taxpayer or otherwise attempt to compel compliance with its information requests. While the Taxpayer did not prevail in these appeals, the board cannot conclude the "matter was frivolously brought, maintained, or defended," the standard for an award of costs stated in TAX 201.39. The City's request for costs is therefore denied.

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, 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 in law. Thus, new evidence and new arguments are only allowed in very limited circumstances as stated in board rule TAX 201.37(f). 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

Paul B. Franklin, Chairman

Michele E. LeBrun, Member

Albert F. Shamash, Esq., Member

Certification

I hereby certify a copy of the foregoing Decision has this date been mailed, postage prepaid, to: David Irwin, Tax Choice Services, Post Office Box 1297, Hillsboro, New Hampshire 03244, representative for the Taxpayer; and Chairman, Board of Assessors, City of Keene, 3 Washington Street, Keene, New Hampshire 03431.

Date: August 18, 2005

Anne M. Stelmach, Clerk