

Sears, Roebuck and Company

v.

City of Manchester

Docket Nos.: 19814-02PT and 20026-03PT

DECISION

The “Taxpayer” appeals, pursuant to RSA 76:16-a, the “City’s” 2002 and 2003 assessment of \$12,300,000 for each year (land \$9,522,200; buildings \$2,777,800) on Map 666/A, Lot 1, an anchor department store consisting of a 139,584 square foot building situated on 10.93 acres of land (the “Property”). For the reasons stated below, the appeals for abatement are denied.

The Taxpayer has the burden of showing, by a preponderance of the evidence, the assessments were 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 assessments were higher than the general level of assessment in the municipality. Id. We find the Taxpayer failed to prove disproportionality.

The Taxpayer argued the assessments were excessive because:

- (1) two appraisals (Taxpayer Exhibits 1 and 2, collectively the “Bramley appraisals”) by a licensed, certified appraiser indicate market values of \$11,100,000 in 2002 and \$11,750,000 in 2003;
- (2) the Bramley appraisals considered the cost and sales comparison approaches, but relied upon the income approach to estimate market value and included a reconciliation of values;
- (3) the main reason for the higher market value estimate in 2003 is a slightly lower capitalization rate (8% rather than 8.5%);
- (4) while the Property is well-maintained, the regional mall sector is in a “mature” phase (with declining shopper visits between 2001 and 2002) and is in competition with free-standing stores such as Target, Kohl’s and Wal-Mart;
- (5) applying the levels of assessment in the City in tax years 2002 and 2003 to the above market value indications results in a substantial abatement for each tax year (as shown in Taxpayer Exhibit 3); and
- (6) the City’s analysis (Municipality Exhibit A) using the cost approach is flawed in terms of the land sale comparables used and lack of adequate depreciation and the City failed to consider adequately the two other recognized approaches to value (income and sales comparison).

The City argued the assessments were proper because:

- (1) the Property is in a “super regional” mall (one of only three in New Hampshire) and such malls are not necessarily in decline like smaller regional or local malls may be;
- (2) the Taxpayer made significant renovations and improvements in 1997-98, adding a 35,200 square foot addition, a new roof and extensive remodeling of the existing improvements at a cost of approximately \$5.86 million (Taxpayer Exhibit 1, p. 18);

- (3) the Bramley appraisals overestimate the amount of physical and functional/economic depreciation for 2002 and 2003 (40% and 46.5%, \$3,127,348 and \$3,632,765, respectively) in light of these renovations and improvements;
- (4) the rental comparables in the Bramley appraisals are of questionable accuracy because, for example: comparison 1 (Vickerry Realty – Kohl’s) included a substantial payment (“in excess of \$1,000,000”) to the prior lessee (Bradlees); comparison 2 (Kmart) uses a leased property dating back to 1990 (lease signed in 1989, as shown in Municipality Exhibit H); and comparison 3 (Bon-Ton) is in a regional mall with two physically separate locations, a physically inferior condition, and much lower sales per square foot compared to the Property;
- (5) land sale comparable 3 in the Bramley appraisals had a higher actual cost than \$10 million because the buyer (Home Depot) was required to pay for demolition of the existing structures which added substantially to the cost;
- (6) land sale comparable 1 involved a sale (for a Target store) in a super regional mall but was not used by Mr. Bramley to estimate land value;
- (7) while the Taxpayer relies on the income approach, it did not present one example of a shopping center anchor leasing rather than owning its property;
- (8) mall dynamics have changed to the point where anchor department stores have less of an ability to negotiate favorable terms with mall owners and therefore historical rental data in national surveys such as the Dollars and Cents of Shopping Centers 2002 and 2004 (“Dollars and Cents”) used by Mr. Bramley are of questionable relevance;
- (9) the City does not believe sufficient, reliable market information is available to use either the income or sales comparison approaches, but both were considered;

(10) the cost approach is the best indicator of value and has been used by the City to arrive at an indicated value of \$21,455,000 and \$22,027,000 (\$153.71 and \$157.80 per square foot) for tax years 2002 and 2003, respectively, as shown in Municipality Exhibit A;

(11) the Property is on one level, which is advantageous in comparison to others (such as the Target store in the Pheasant Lane Mall purchased from Lechmere which has two levels);

(12) the other anchor department stores in the same mall (the Mall of New Hampshire) are consistently assessed with the Property; and

(13) if anything, the Property is significantly underassessed instead of being overassessed.

The board consolidated these appeals for hearing and decision. The parties stipulated that the levels of assessment in the City were 0.766 for 2002 and 0.651 for 2003.

Board's Rulings

After review of the extensive evidence submitted during the two day hearing, the board finds, for the following reasons, the Taxpayer did not carry its burden that the \$12,300,000 assessment was disproportionate.

The parties agree the highest and best use of the Property is as an anchor department store, but disagree regarding which of the three approaches to value should be relied upon to arrive at market value. As noted above, the Taxpayer emphasized the income approach and the City focused on the cost approach.

The Taxpayer has the burden of proof of showing that the assessed value is disproportionate relative to market value and the municipality's level of assessment. Inasmuch as the parties have stipulated to the levels of assessment, the relative indicated market values by equalizing the assessed value for each year under appeal is \$16,057,441 (\$12,300,000 divided by 0.766) for tax year 2002 and \$18,894,009 (\$12,300,000 divided by 0.651) for tax year 2003.

The Taxpayer submitted the Bramley appraisals for each year as its primary evidence of market value for the Property. The Bramley appraisals relied primarily upon the income approach. The linchpin of the income approach was the market rent estimate for the Property of \$7.25 which then generated the net operating income and, when capitalized, produced the Property's estimated values in the appraisals.

For the following reasons, the board finds the Taxpayer's market value estimates (as largely derived from the income approach) failed to carry its burden.

The income approach to value is applicable to properties that typically throw off a predictable income stream and to properties that are acquired as investments due to their income potential. In most instances, owner-occupied properties are not valued by the income approach because, by their very nature, they do not produce an income stream separate from the ownership interest in the property. Here, not only is this Property owner-occupied but evidence was submitted that nearly all anchor department stores in the three super regional malls in New Hampshire are owner-occupied rather than leased. As a consequence, neither party was able to identify any rental market data that was truly comparable to the Property. "The income approach ... may be used to value both vacant and improved properties, providing that a sample of such properties is leased or rented in the market." (Emphasis added). Mass Appraisal of Real Property, International Association of Assessing Officers (IAAO 1999) at p. 20. Because of the owner-occupied nature of the Property and comparable properties in New Hampshire, and the resulting dearth of market rental data, the income approach is not the best approach to valuing the Property. With that general finding in mind, the board makes the following specific findings relative to the three rental comparables in the Bramley appraisals.

Bramley's comparable rental 1 is a lease that commenced in May 2003 between Kohl's Department Stores, Inc. ("Kohl's"), as the tenant, and Vickerry Realty Company Trust ("Vickerry"), as the landlord, for an 86,584 square foot building. While proximate in time to the years under appeal, the property is located at the Nashua Mall which is a regional mall and thus does not have the traffic and attraction that the Mall of New Hampshire has as a super regional mall. Also, Kohl's acquired the prior tenant's lease (Bradlees) for an amount in excess of \$1,000,000 but did not occupy the old Bradlees' store. Instead, the old store was demolished and a new building constructed by Kohl's construction division, with the costs billed to Vickerry, and then leased back to Kohl's at \$10.75 a square foot, triple-net. Kohl's acquisition of Bradlees' lease, so as to be able to locate their store at this site and the construction and lease back arrangement struck with Vickerry, are all factors that could have a bearing on the determination of market rent for this location, as opposed to the stated contract rent between Kohl's and Vickerry used by Mr. Bramley.

While it is difficult to estimate how these factors might affect the market rent indication, they should have been discussed and considered when arriving at an indicated market rent. The Bramley appraisals, other than noting Kohl's acquisition of Bradlees' lease, have no discussion as to its bearing on market rent. The Bramley appraisals then go on to adjust the contract rent between Kohl's and Vickerry 30% for the "quality condition," but contains no discussion as to why 30% is appropriate compared to the Sears store, which is older, but renovated and well maintained. Also, while mention was made in the Bramley appraisals of the Nashua Mall being an inferior location, no adjustment was made for that inferior location. For all these reasons, Bramley's adjusted indicated rent of \$7.25 from this comparable is not indicative of the Property's potential rent.

Bramley's second rental comparable was for 86,479 square feet rented by Kmart at the Somerset Plaza, a community/neighborhood shopping center in Nashua. The lease was commenced in 1989 for a fixed rate of \$6.00 a square foot for 25 years with five 5-year options for renewal providing for rent increases after the first 25 years. The board gives little weight to the fixed rental rate as being comparable to the Property because it is in a significantly inferior location, both in a macro and micro sense, and because it was commenced in a depressed market after the banking problems of the late 1980's at a fixed rental rate with no increases until 2015. While Mr. Bramley adjusted the rental rate 10% for the location, the board finds this is greatly inadequate given the Mall of New Hampshire's excellent location on Interstate 293 ("I-293") and regional draw as compared to the Community Shopping Center of the Somerset Plaza on Amherst Street in Nashua. Further, in a micro sense, the Property has a highly visible location within the Mall of New Hampshire located at the intersection of Route 28 (South Willow Street) and I-293. While Amherst Street is a busy area in Nashua, it does not have the exposure to an interstate highway as the Property does.

It is well established by the case law in New Hampshire that long term contract rents that are not reflective of current market value are to be given little weight in determining properties' market value. "[W]here the actual income from long term leases does not reflect the true value of the property because the leases were made in a time of boom or depression or as a result of poor management, the board may reject or give little weight to the capitalization of actual or net income method." T. A. Demoulas, Trustee of Delta & Delta Realty Trust v. Town of Salem, 116 N.H. 775, 782 (1976). See also Appeal of Net Realty Holding Trust, 128 N.H. 795, 800 (1986); and Coliseum Vickerry Realty Co. Trust v. City of Nashua, 126 N.H. 368, 370 (1985).

Consequently, given the inferior location of the Kmart property and its commencement date

during a depressed time in the real estate market significantly prior to the tax years under appeal, the board gives no weight to Bramley's comparable rental 2.

Bramley's comparable rental 3 is the Bon-Ton space at the Steeplegate Mall in Concord, New Hampshire. The board finds this rental rate of \$5.50 a square foot entered into in 1999 is also not comparable to the Property for several reasons. First, the Steeplegate Mall is not a super regional mall, does not draw from as large an area as the Mall of New Hampshire and is not immediately adjacent to, or visible from, an interstate highway. Second, the Bon-Ton store is comprised of nearly 88,000 square feet; however it is separated into two distinct sections at the Steeplegate Mall joined only by the common public mall area. Both these factors diminish significantly the reliability of the market rental rate indication for the Property that can be derived from the Bon-Ton contract rent. Again, while Mr. Bramley adjusted for the location of the property, his appraisals provide no indication that he adjusted for the separation of the Bon-Ton space (although he asserted during testimony at hearing that this factor was considered). Regardless, the board finds the 25% adjustment for location alone or combination of the two factors is significantly inadequate to arrive at an appropriate rental rate for the Property.

The above review of the Bramley rental comparables highlights the difficulty in utilizing the income approach in a reliable fashion to estimate the market value of the Property. The only contract rents available to utilize are significantly inferior for the reasons stated. Because the income approach relates largely to both principles of anticipation of future income stream and principle of substitution, it is difficult to see how an investor would find any of the three rental comparables attractive alternative investments to the Property given the Property's significantly superior location.

While the board finds the Bramley appraisals' rental rates as adjusted do not arrive at a reliable indication of market value, it is conceivable the income approach could be utilized if rental rates truly indicative of regional mall anchor stores existed or can be deduced from market data in the record. The board believes some of the market data does provide some insight as to what super regional store anchor market rents might be. For example, despite its shortcomings noted earlier, the Kohl's rental rate of \$10.75 a square foot triple-net provides some indication of market rent. The building was new but not so dissimilar from the Sears building, which, while older, has been renovated, added on to and well maintained. Further, Bramley sales comparable number 2 is of the former Lechmere store at the Mall of New Hampshire which a portion of (42,000 square feet) is now leased to Best Buy in a lease commencing in the late 1990's for \$18.00 a square foot triple-net. The Taxpayer argued the Best Buy space is smaller and is a specialized space generally occupied by "big box" type enterprises and thus is not comparable to the Sears anchor store property. While the board acknowledges some difference, we do not believe they are so different to preclude some rental comparison.

Certainly if Sears were to no longer occupy the Property, its excellent location would allow it to be utilized in some alternative fashion, either reconfigured for another anchor or larger "big box" store (such as Target or Home Depot) or divided into perhaps two or three smaller spaces for specialized "big box" stores (such as Best Buy). (This process was described at hearing as "repositioning" a property in the market.) Such repositioning would entail significant renovations but the main structure, in the board's opinion, is of such good caliber and in a functional configuration that it would be unlikely it would be torn down. Thus, there are some indications of rents in the \$10.75 to \$18.00 range, albeit with renovations involved, as to what could be expected for market rent at this location.

To see if the City's assessed values are reasonable relative to this rental range, the board has equalized the assessments by the stipulated ratios (providing market value indications for 2002 of \$16,057,441 and for 2003 of \$18,894,009) and has worked these value indications back through the Bramley appraisals' income approach methodology accepting the capitalization rates and expense and vacancy estimates as reasonable to arrive at indicated rental rates necessary to support those value indications. The rental rates indicated by this analysis are approximately \$10.40 and \$11.50 per square foot for tax year 2002 and 2003, as depicted in the following table:

| RENTAL RATES | | |
|------------------------------------|--------------|--------------|
| | 2002 | 2003 |
| ASSESSED VALUE | \$12,300,000 | \$12,300,000 |
| EQUALIZED RATIO | 0.766 | 0.651 |
| TOTAL ASSESSED VALUE | \$16,057,441 | \$18,894,009 |
| CAPITALIZATION RATE | 0.085 | 0.080 |
| INDICATED NET OPERATING INCOME | \$1,364,883 | \$1,511,521 |
| VACANCY & MANAGEMENT (3%) | 0.970 | 0.970 |
| TOTAL | \$1,407,095 | \$1,558,269 |
| REPLACEMENT RESERVE @ \$0.30/SQ FT | \$41,875 | \$41,875 |
| INDICATED POTENTIAL GROSS INCOME | \$1,448,970 | \$1,600,144 |
| SQUARE FEET OF BUILDING | 139,584 | 139,584 |
| INDICATED RENT PER SQUARE FOOT | \$10.38 | \$11.46 |

These indicated rental rates are essentially at the Kohl's rental rate in a significantly inferior location, albeit for a newer building, and are significantly lower than the reconfigured Best Buy store with the Mall of New Hampshire and thus do not seem unreasonable relative to those indications of market rents.

The \$10.40 and \$11.50 per square foot indications are, however, higher than the Dollars and Cents tabular surveys contained in the Bramley appraisals. However, the City's unrefuted testimony was that nationwide there are approximately 2100 regional malls of which 400 or so

could be considered super regional malls and that the Dollars and Cents respondents were from only 124 of that entire mall population. The City also testified that one company, the Simon Property Group, has controlling interest in 253 of the 400 or so super regional malls in the nation and does not respond to surveys such as those in Dollars and Cents. Thus, the board agrees with the City that it is questionable whether the Dollars and Cents rental rates are really relevant to the Property's good location in a super regional mall in southern New Hampshire. Consequently, while the rental rates of \$10.40 and \$11.50 indicated by the City's assessments exceed those reported in the Dollars and Cents survey, we do not find that compelling because the unrefuted evidence was that the survey was likely of stores in inferior locations and malls and thus not representative rates for the Property.

Both parties agree that the highest and best use of the Property was as an anchor department store within the super regional mall. There is evidence, which the board has referred to above, where in two instances at least (Bramley comparable sales number 1 and number 2) portions of super regional malls (Pheasant Lane Mall in Nashua and Mall of New Hampshire in Manchester) have been reconfigured to include stores that are more traditionally termed as larger or specialized "big box" stores (Target and Best Buy in these instances). The board finds this market evidence is indicative of the potential for the Sears site if Sears were to no longer occupy its building. While the former Lechmere store at the Pheasant Lane Mall was demolished prior to the Target store being built, the board agrees with the City this was likely necessitated: 1) because of the two-level configuration of the Lechmere store not being conducive to the marketing approach of the Target store; and 2) because the Lechmere store was smaller in square footage than the ultimate Target store. Thus, the razing of the Lechmere store is not necessarily indicative as to what would occur at the Property if vacated. These two reconfigurations indicate

that at these super regional malls there is a hybrid or integration of more traditional anchor store uses with “big box” uses to provide even further synergy and draw of customers to super regional malls that could be applicable as an alternative use to the Sears building if vacated.

Because the Taxpayer relied extensively on the income approach and utilized the cost and sales approach as a check to the income approach value indication, the board’s findings relative to the other two approaches will be briefer.

As with rental data for the income approach, so were there very few sales of comparable super regional mall anchor stores to perform the sales approach and what few sales occurred required such significant adjustments, it was difficult to place much reliance on the value conclusions. For instance, Bramley comparable sale 1 was of the Lechmere store at the Pheasant Lane Mall in Nashua which was, after purchase, torn down and replaced with a larger Target store. Consequently, it is questionable whether any of the sale price was attributable to the Lechmere building, as his analysis assumed, or if the sale price was indicative of only the site value. Bramley comparable sale number 2 was of the former Lechmere store at the Mall of New Hampshire reconfigured to accommodate Best Buy as a tenant occupying about 2/3 of the 62,485 square feet of the building and another tenant occupying the balance of the space. Because this sale is for a significantly smaller area (about 45% the size of the Property) some adjustment to make it comparable to the Property would be necessary (Mr. Bramley applied a 15% adjustment.) However, of the two sales available, it is probably the most comparable given it is located within the Mall of New Hampshire as is Sears and indicates an alternate potential for the Sears store if converted. Further, the board agrees with the Taxpayer that the \$12,000,000 sale in 1999 was after the property was reconfigured to accommodate two tenants and thus some

adjustment would be warranted.¹ However, its earlier sale in 1997 for \$8,250,000, if nominal adjustments are made for the fact that it was acquired out of bankruptcy, for market appreciation from 1997 to 2002 and the fact it is approximately half the size of the Property (collectively these adjustments are probably offsetting), would indicate sales price per square foot of \$132.03. This is similar to that indicated by the City's equalized assessments for the Property (\$115.04 for 2002 and \$135.36 for 2003). A further consideration is the City's testimony that comparable sale number 2 is in a less favorable location in the Mall of New Hampshire than the Property. On balance the board finds this sale, while having many differences from the subject Property, has enough similarities that an adjusted indicated sales price is generally supportive of the City's assessed value.

The board gives little weight to the Bramley appraisals' cost approach for two reasons. First, the physical depreciation applied to the building appears excessive given the Property's renovations in 1997 and 1998 and its well maintained condition. While the board understands Mr. Bramley's high depreciation is intended to account for the likelihood of the Property being significantly renovated or torn down if sold, the board, as discussed above, does not find that conclusion reasonable. Sears built the original structure in 1976 in this excellent location of the Mall of New Hampshire and added on to and renovated the Property significantly in 1997 through 1998. This long occupancy by Sears, while partially a testament to Sears' viability as a company, is also an indication as to the viability of the real estate. The fact that Sears has been located successfully at this location for that many years is some indication of the Property's value and likelihood to be continued to be used as an anchor facility in the future. The board is

¹ Mr. Bramley adjusted the sale 50% for the fact it was "released as a non-anchor store sold by the former mall owner to the present mall owner"... requiring "a 50% downward adjustment for the lease interest." (Taxpayer Exhibit 1 at p. 30) The board finds such a large adjustment was not adequately discussed in the Bramley appraisals and is excessive as the Sears store has similar potential.

not convinced that the regional mall economic ailments noted by the Taxpayer apply to any large degree to super regional malls and in particular to this excellent location within the Mall of New Hampshire. The store's sales per square foot in excess of \$300, as indicated in the Bramley appraisals, is indicative both of the nature of the merchandise sold by Sears, the Property's highest and best use as an anchor store and the excellent location and traffic that being at the Mall of New Hampshire provides. Further, the functional depreciation applied in the Bramley appraisals is derived directly from the income approach and thus is circular in nature. Given the board has found significant shortcomings in the income approach analysis, we find the 40 plus percent functional depreciation in the cost approach is also flawed.

The Taxpayer argues, as the Bramley appraisals reflect, that the store improvements, while well maintained, are obsolete to anyone other than Sears and would be either torn down or totally renovated to suit the unique façade, layout and "motif" desires of any other anchor store. This argument, taken to its extreme, would result in any store that has design features unique to the occupant's identity being minimally assessed. The City noted that such an argument might suggest the Property approaches being a "limited-market" or "special purpose" property. See Appraisal Institute, *The Appraisal of Real Estate*, pp. 25-26 (12th edition 2001). Without definitively ruling whether the Property is such a specialized type property, high functional depreciation for such property is appropriate only if there is little or no demand for its continued use. Id at 262-263. As noted above, the evidence is to the contrary; Sears has occupied, expanded, renovated the store for a number of years and no evidence was presented that its continued use was not its highest and best use. To find such high physical and functional/economic depreciations as claimed by the Taxpayer would result in valuable taxable features being utilized by Sears escaping taxation. When a property has unique features that add

value to achieve its highest and best use, such features must be considered and valued. See 590 Realty Co., Ltd v. City of Keene, 122 N.H. 284, 286-287 (1982); Public Service Company of New Hampshire v. Town of Ashland, 117 N.H. 635 (1977).

In summary, the board concludes the Bramley appraisals' sales, cost or income approaches result in a reliable independent indication of market value for the Property. As a result, the board finds the Taxpayer has not presented adequate evidence to prove that it was disproportionately assessed.

Consequently, the board need not make detailed findings relative to the City's cost approach estimate of market value contained in Municipality Exhibit A of \$21,455,000 and \$22,027,000 for tax years 2002 and 2003 respectively. However, the board would note that significant errors would have to be found in the City's calculation of the underlying land value and/or depreciation in its cost approach to reduce its estimated market value findings down to the \$16,057,441 and \$18,894,009 equalized assessments. While possibly some adjustments could be warranted, the board finds the City did not err to any such extent, and thus there is no evidence submitted in the City's presentation to warrant any abatement below the appealed assessed values.

The board further notes the City makes a compelling argument that the cost approach for a well maintained property such as the Property may be a preferable approach to value because it reassembles all the sticks of the bundle of rights that the Taxpayer owns that may be fragmented through the reciprocal agreements between the Taxpayer and the Mall of New Hampshire owners. It is, as the City argues, the total absolute bundle of rights in a property that must be valued and taxed regardless of how they are fragmented amongst the various interests to a property. Because the income and sales approach rely upon market data of properties that may

be similarly fragmented, the value indications by that data may not be inclusive of the entire bundle of rights; however, the cost approach does reassemble those rights.

In conclusion, the board finds the Taxpayer failed to present compelling evidence through the Bramley appraisals that the assessments were excessive and nothing in the City's testimony raised concern as to the accuracy of the assessments relative to market value.

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

Albert F. Shamash, Esq., Member

Certification

I hereby certify a copy of the foregoing Decision has this date been mailed, postage prepaid, to: David G. Saliba, Esq., Saliba & Saliba, P.O. Box 8796, Boston, MA 02114, Taxpayer Representative; and Chairman, Board of Assessors, City of Manchester, One City Hall Plaza-West Wing, Manchester, NH 03101.

Date: 3/28/06

Anne M. Stelmach, Clerk