McDonald’s Corporation

v.

Town of Goffstown

Docket Nos.: 21279-04PT/22356-05PT

DECISION

The “Taxpayer” appeals, pursuant to RSA 76:16-a, the “Town’s” 2004 assessment of $986,100 (land $553,000; building $433,100) and 2005 assessment of $934,000 (land $497,800; building $436,200) on Map 18/Lot 58, a McDonald’s franchise restaurant on 1.69 acres at 569 Mast Road (the “Property”). For the reasons stated below, the appeals for abatement are granted.

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 assessments were higher than the general level of assessment in the municipality. Id. The Taxpayer carried this burden.

The Taxpayer argued the assessments were excessive because:

(1) the restaurant on the Property was built in 1984 and, because it is relatively old, has functional and economic obsolescence compared to newer McDonald's restaurant properties, including labor and energy inefficiencies;

(2) other older restaurants owned by the same McDonald's franchisee (Emile Haddad), such as one in Derry, have been torn down and rebuilt, and he has plans to rebuild the McDonald's in Hooksett and then the Property;

(3) because of the steep incline down to Barnard Brook, the usable land is no more than 1 to 1.15 acres and the land is settling all the time, requiring repaving and other maintenance issues;

(4) as indicated in the franchisee circular (Taxpayer Exhibit No. 4), McDonald's provides a number of services that are included in the "single payment" paid and referred to as "percentage rent" and, as a result, rental on the real estate (land and building) cannot be isolated as a separate item;

(5) an appraisal prepared for the Taxpayer (the "Blumenthal Appraisal") estimates the market value of the Property to be $715,000 and $745,000 as of April 1, 2004 and April 1, 2005, respectively (<u>see</u> Taxpayer Exhibit No. 1 and the "corrective sheets" contained in Taxpayer Exhibit No. 6), giving equal weight to the sales and income approaches and "no weight" to the cost approach;

(6) the Property is not on a corner, signalized intersection, making it less desirable and valuable, and is no longer in the best location in the Town because of changes in traffic patterns;

(7) it is not appropriate to use the percentage sales or service fee payments to determine the value for <u>ad</u> <u>valorem</u>, real property tax purposes because they involve what is referred to in various contexts as business, franchise, going concern and/or intangible value;

(8) the Town's appraisal failed to make appropriate adjustments with its comparables for factors such as corner lot and higher traffic and better demographic locations (see maps and photographs in "Rebuttal," Taxpayer Exhibit No. 3; and

(9) the Town reduced the land adjustment factor in 2005 (from 5 to 4.5) and this change should also be made for 2004.

The Town argued the assessments (except for relatively minor adjustments based on the estimates in the Town's appraisal (see Municipality Exhibit No. A, the "Bartlett Appraisal") were generally proper because:

(1) the Property is located in the best commercial area of the Town, with a "huge draw" from residential and college customers;

(2) the Town's assessor inspected the Property and three other fast food properties (Pizza Hut, Burger King and Dunkin Donuts) in the same neighborhood and concluded the assessments were consistent and proportional;

(3) the Taxpayer's appraiser was inconsistent in selecting comparables in light of his conclusion regarding the highest and best use (fast food restaurant with drive-up window);

(4) the Taxpayer's choice of comparables is questionable because comparable B-1 was converted from a bank to a beauty salon in 2001 and resold for the same use in 2003; comparable B-2 is a former "Wendy's" that is no longer being used as a fast food location and several of the other comparables have legal restrictions that preclude use of each as a fast food restaurant;

(5) the Taxpayer's land sale comparables are not reliable because Comp. L-1 and L-2, for example, were not arm's-length transactions and/or involved other extraneous factors;

(6) while franchise value should not be included, the value of the Property is affected by its highest and best use as a fast food restaurant;

(7) the Bartlett Appraisal estimates the market value of the Property to be $1,100,000 and $1,150,000 as of April 1, 2004 and April 1, 2005, respectively, giving the most weight to the income and cost approaches to value and lesser weight to the sales comparison approach;

(8) while the Property could be renovated to become more efficient, there is no indication of any functional or economic obsolescence because the restaurant is operating successfully in its present condition and with its present size; and

(9) minor abatements may be warranted (based on the Town's appraisal estimates adjusted by the levels of assessment), but to grant a more substantial abatement would lead to greater inequity for assessments of other restaurants in the Town.

The parties stipulated the levels of assessment in the Town were 85.7% in tax year 2004 and 77.2% in tax year 2005.

Board's Rulings

Based on the evidence, the board finds the proper assessments to be $758,400 for 2004 and $718,000 for 2005, based on market value estimates of $885,000 and $930,000, respectively.

The primary focus of this appeal is the market value of the Property as of the assessment dates. The Town's indicated market values (assessments adjusted by the level of assessment) are approximately $435,000 and $465,000 higher than the Taxpayer's market value estimates for tax year 2004 and 2005.

The parties generally agreed on the highest and best use being a fast food restaurant with a drive-up window.

Both the Blumenthal and Bartlett Appraisals employed all three approaches to value: cost, sales and income and all three are recognized and accepted in the profession. See The Appraisal Institute, The Appraisal of Real Estate, Ch. 5, p. 79-71 (11th ed. 1996). While there are three approaches to value, not all three approaches are of equal import in every situation. Id. at 81; International Association of Assessing Officers, Property Appraisal and Assessment Administration, Ch. 4, p. 108 (1990). 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 reviewing the 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 cost approach is the most appropriate approach to value for the following reasons.

Because fast food restaurants are sold and, at times, are leased, the sales and income approaches are conceivably approaches to consider in valuing the Property. Both Mr. Blumenthal and Mr. Bartlett valued the Property by those two approaches. However, despite their good efforts, the board finds that, either due to the paucity or reliability of data or the magnitude of the assumptions and adjustments necessary, little weight can be given to the market value indications of the Property by those two approaches.

For instance, the Blumenthal Appraisal sales approach involved several sales that as the Town properly pointed out, did not encompass the same bundle of rights as the Property, which is an improved and operating fast food restaurant. Comparable B-1, while it had been a former branch bank, sold after it had been converted to a beauty parlor and does not reflect the same rights as the subject. Comparable B-2 had been a Wendy's Restaurant; however, apparently due to changes in the real estate market in that area, it was no longer viable as such and had been purchased and used by an adjoining automobile dealership for parking. Similarly, comparable B-3 had been a former fast food restaurant (Taco Bell) but had sold to be used as a doughnut shop with a restriction it could not be used as a competing fast food restaurant. The board finds none of these three sales could have accommodated a McDonald's similar to the Property and thus are not good comparables to value the total bundle of rights embodied in the Property. Further, comparable B-4, which is utilized in the Blumenthal Appraisal 2005 sales approach estimate, was purchased by an entity to be marketed as a '1031 tax exchange' and, as argued by the Town, the grantee could possibly have been a subsidiary of the grantor. Consequently, none of the sales contained in the Blumenthal Appraisal sales approach provide a reliable estimate of market value.

The Bartlett Appraisal sales approach utilized six sales of Friendly's, Burger King and Bickford's restaurants located in Nashua, Manchester, Concord and Dover. Adjustments for both size of the property and their locations were made to attempt to arrive at a sale price per square foot to be applied to estimate the subject Property's value. However, as Mr. Bartlett conceded, the adjustments for location are subjective and, because the locational differences are so significant (e.g., Willow Street, Manchester and Amherst Street, Nashua), the relatively minor (0% – 35%) location adjustments are suspect. Based on the board's knowledge of those comparable locations, which have greater traffic volumes, better proximity to interstate highways and more favorable regional demographics, the board finds the location adjustments to be inadequate to account for the significantly superior locations of those comparables. (See also Taxpayer Exhibit No. 3.)

In summary, while the sales approach is a potentially plausible method for estimating the Property's value, none of the sales submitted by either party provide reliable indices for estimating the Property's market value by this approach.

The income approach is even more difficult and less reliable, in the board's opinion, for estimating the Property's value. Based on the testimony of Mr. Haddad, the franchisee owner of the Property, in most cases, McDonald's owns the real estate (either in fee simple or, in a few instances where McDonald's secures the site through a land lease). The franchisee pays McDonald's Corporation a combined rent and royalty payment (see Taxpayer Exhibit No. 4) that can vary based on each restaurant's sales volume or on specific factors relative to the stage of development or economic viability of each specific McDonald's restaurant. Only a portion of this payment to McDonald's by the franchisee constitutes rent for the real estate. As Mr. Haddad, an experienced franchisee, testified to, and as Taxpayer Exhibit No. 4 outlines, a very significant portion of the rent and royalty payment relates to the franchise and other non-taxable aspects of the going concern or business value of the McDonald's restaurant.

To avoid having to attempt to split apart the realty from the business value, the Blumenthal Appraisal used eight rental comparables (six actual, two asking rental rates) to estimate a potential gross income to capitalize. However, the board agrees with the Town that none of the eight rental comparables could either physically or competitively accommodate a McDonald's operation such as that under appeal. Comparable R-5, a bank property, probably comes the closest to a rental rate that is similar to a viable fast food location; however, the board was not convinced that location and building could be employed to the same extent as the Property under appeal. The two asking rental rates are of vacated Wendy's and McDonald's facilities in Portsmouth and Milford, respectively. However, both locations appear to have had a change in desirability due to shifts in traffic patterns. (For example, Mr. Haddad testified the Milford location, which he had owned, had been negatively impacted by the recent bypass around Milford.) Further, these asking rental rates also reflect the restriction common with most vacated fast food restaurant locations that any new use be one that would not compete with a fast food restaurant. In summary, while the board understands Mr. Blumenthal's motivation to identify and utilize rentals free from any non-realty interests as the basis for the income approach estimate for the Property, we find they are all inferior for the reasons stated above and fall short of providing a reliable indication of value.

For its part, the Bartlett Appraisal also attempted to employ the income approach by making several calculations contained in Exhibit No. 1, to estimate the portion of the rent and royalty payment that could reasonably be attributed to rental income from the real estate. The board appreciates the effort employed by Mr. Bartlett and the research he undertook to arrive at an estimated net operating income by this method. However, the board is unable to place any weight on the resulting estimate of market value for several reasons. First, to derive his rental estimate involved a significant number of assumptions that have no independent or corroborated market support. Second, the basis for those assumptions was largely drawn from information received from Steven Traub, another appraiser, who was not present at the hearing. Third, the ownership, location and nature of the properties from which it was derived was, for confidentiality reasons, not identified.

As the result of the difficulties or shortcomings of the sales comparison and income approaches discussed above, the board concludes the cost approach, notwithstanding some of the inherent difficulties in properly employing that approach, is the best approach to valuing the Property. One significant benefit of utilizing the cost approach in valuing a going concern such as the Property is that it inherently winnows out any franchise/business value (because it entails estimating the value of the land by the comparable sales approach and the contributory value of the improvements by replacement cost less depreciation methodology).

The board, utilizing its own experience and knowledge in reviewing closely the various land sales' assumptions and adjustments and the Marshall Valuation Service cost calculations for the improvements employed by both appraisers, has developed its own cost approach estimate summarized on the following page. The various factors and assumptions are all drawn from the evidence presented at hearing either by Mr. Blumenthal, Mr. Haddad or Mr. Bartlett.

Land

The parties disagreed both as to the usable area of the lot and the value per square foot of usable area. The Taxpayer estimated that the usable area approximated 1 to 1.15 acres (43,560 to 50,000 square feet) while Mr. Bartlett estimated the usable area to be 60,000 square feet. The Taxpayer's estimate was based on Mr. Haddad's personal knowledge from the development and use of the Property as a franchisee. Mr. Bartlett estimated the usable area of the lot by delineating from an aerial photo the impervious surface area of the improvements on the Taxpayer's lot and then adding some additional area necessary for the development of the lot.

A number of aerial photos and plans submitted indicate the northern and eastern portions of the lot are encumbered with the slopes and brook bed associated with Barnard Brook which limits significantly the utility of the overall area of 1.68 acres. Mr. Bartlett on Municipality Exhibit No. H outlined his understanding of the bounds of the lot and the impervious area of the lot to estimate the usable area. However, his outline of the portion of the lot along Mast Road was actually part of the highway right-of-way that is outside the Property's ownership. Specifically an area adjacent to Mast Road (see Parcel C on plan at Tab C of the Bartlett Appraisal, Municipality Exhibit No. A) was reserved and not transferred as part of the McDonald's Property. Considering all the evidence contained inw the various plans, the board concludes the Taxpayer's estimate of 1 to 1.15 acres is a reasonable estimate of the useful area of the lot.

The board was unable to place any weight on the land sales employed in the Blumenthal Appraisal because again, as the Town pointed out, none of the sales are reflective of the property rights of the land associated with the Property under appeal. Two of the sales involve parcels that, while conceivably could be developed with a fast food restaurant, do not reflect all the rights the Property has as a completely permitted and constructed fast food restaurant. The Property's location due to its zoning, obtained permits and diminished risk of completed construction has more transmissible rights than either a vacant parcel or a parcel developed for another use. Those rights all need to be accounted for and reflected in either the choice of the comparables or the adjustments made to them. In addition, one of the comparables, L-2, was of a 50% buy-out of interest between family members and would not be considered an arm's-length transaction because it had not been properly exposed to the market and subject to competitive market forces. A further indication that the Blumenthal comparables fall short of the mark of valuing all the property rights is the fact that Mr. Blumenthal's cost approach was approximately $100,000 below his estimates by the other two approaches and thus indicative that either the value of the land or the building component had not been properly estimated.

The board reviewed the Goffstown sales and the three vacant land sales from Dover, Lee and Epping employed in the Bartlett Appraisal, and while we cannot adopt the Bartlett Appraisal's value conclusion, we give them more weight and with further adjustments, arrive at a reasonable estimate of the Property's land value. The Bartlett Appraisal arrived at a correlated estimate of $9.75 per square foot which was then applied to an estimated usable area of 60,000 square feet for a site value estimate for 2004 of $585,000. The board is unable to adopt the $9.75 square foot conclusion because, as pointed out on rebuttal by the Taxpayer, two of the Town's comparables are corner lots which have a beneficial influence for commercial properties but no adjustment was made. Moreover, the three non-Goffstown sales, in superior locations, were sold for fast food restaurant uses and indicated a site value with approvals of $525,000 to $550,000 for a developable site. Based on the testimony of Mr. Haddad as to the attributes of those three sites and the board's own familiarity with these locations, the board finds those sites are generally superior not only from a traffic count perspective but also from the nature of the traffic at those locations. The Lee Route 4 location, the Epping Route 125 location and the Dover location just off the Spaulding Turnpike are major thoroughfares for commuting, vacation and other travel and are excellent locations for fast food restaurants. Consequently, if those superior sites sold for $525,000 to $550,000, the board concludes the Goffstown site should have a value lower rather than higher, contrary to the indication in the Bartlett Appraisal.

Taking into account these differences and the lack of adjustments, the board concludes that the Goffstown land has a contributory market value as permitted and improved of $450,000 in 2004 and $475,000 in 2005.

Replacement Cost Estimate of Improvements

Both the Blumenthal Appraisal and the Bartlett Appraisal estimated the building value utilizing replacement cost estimates from the Marshall Valuation Service; however, the main difference in their estimates is that the Blumenthal Appraisal graded the building as "good" while the Bartlett Appraisal estimated the building as "very good". After review of all the photographs submitted, the descriptions presented in testimony at hearing and a review of the Marshall Valuation Service description and photographs, the board concludes the "good" category and resulting price per square foot is more accurate than the Bartlett Appraisal's grading as "very good" which resulted in adjusted replacement cost new of $171 and $184 per square foot. These replacement cost estimates seem excessive for the construction features of this typical or average McDonald's restaurant and also appeared excessive compared to the testimony of Mr. Haddad as to his recollection of recent construction costs of another McDonald's building which he owns. As a consequence, the board's two replacement cost estimates utilizing the Marshall Valuation adjustments for current cost adjustment, local adjustment, area perimeter adjustment and adding for the "extreme" climate location results in adjusted replacement costs per square foot of $134.34 for 2004 and $144.02 for 2005.

The board, after reviewing the photographs of the Property, has adopted the Bartlett Appraisal estimate of a 15-year effective life given the general good upkeep of the building that was built in 1984. Thus, the physical depreciation based on the Marshall Valuation life expectancy of 35 years for a fast food restaurant is 26% for 2004 and 28% for 2005.

The board gave careful consideration as to whether functional obsolescence was appropriate to be applied and concluded that 10% depreciation is necessary to account for the Property's competitive disadvantage due to its older and less efficient layout and being larger than the current standard of 3,500 square foot. The Property was built in 1984 when a larger percentage of the fast food customers ate in the adjoining dining areas. Today, as Mr. Haddad testified, the majority (70%) of the business stems from the drive-up facilities and thus the larger square footage of the dining area is super adequacy for today's market and demographics and entail unnecessary heating, lighting and maintenance costs. The present structure includes a 'playland' and the evidence suggested this area would be removed when the restaurant is rebuilt to respond to changing demographics. Further, as Mr. Haddad testified, there have been improvements in the design of modern kitchen layout and drive-up facilities that make this Property, if it were to be put on the market, inferior to competing, newer McDonald's buildings.

The board disagrees with Mr. Bartlett's argument that no functional obsolescence is necessary because, while the Property is not perfect, it is operating in a functional manner. The board finds that this is not the test for determining functional obsolescence. See Appraisal Institute, The Appraisal of Real Estate 11th ed. at pp. 337 and 365 – 366. The Marshall Valuation estimates are based on replacement costs based on current standards in the market. Marshall Valuation's general descriptions of fast food restaurants noted, as did Mr. Haddad, the current standard size is approximately 3,500 square feet. Consequently, Marshall Valuation's replacement costs are for a building of standard size and layout that provides current state-of-the-art utilization. Thus, any such property that has significant deviation from the current design standard would be at a competitive disadvantage in efficiently achieving its highest and best use as a fast food restaurant and would warrant some functional depreciation. Considering its size of 4,037 square feet and the interior layout design and modifications testified to, the board finds the Blumenthal Appraisal's 15% adjustment a bit excessive and reduces it to 10%

The board agrees with the Blumenthal Appraisal methodology of adding an estimated developer's profit to the depreciated replacement cost new of the improvements. Marshall Valuation Services notes that its replacement costs encompass most soft and hard costs, including contractors' profit, but not developer or entrepreneurial profit. Because entrepreneurial profit is the reward for the risk and managerial skills for developing an entire property, it is reflected in the sale of properties when the market is in balance, and thus it is appropriate to add to the cost calculation of the building. While no specific evidence was submitted other than a statement that a 10-15% range is appropriate, the board concludes 10% is not unreasonable given the alternate investment opportunities that a developer would have had in the 2004-2005 time frame for such funds.

Adding the land estimate to the replacement cost estimate, the board estimates that for 2004 the market value was $885,000 and for 2005 it was $930,000 (as shown on the summary table on the following page of this Decision). Applying the stipulated levels of assessment of 85.7% for 2004 and 77.2% for 2005 to these market value estimates produces (rounded) assessed values of $758,400 for 2004 and $718,000 for 2005.

If the taxes have been paid, the amount paid on the value in excess of $758,400 for 2004 and $718,000 for 2005 shall be refunded with interest at six percent per annum from date paid to refund date. RSA 76:17-a. Until the Town undergoes a general reassessment or in good faith reappraises the property pursuant to RSA 75:8, the Town shall use the ordered assessment for subsequent years. RSA 76:17-c, I and II.

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(g). 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.

	M.V.S. Ref.	4/1/2004	M.V.S. Ref.	4/1/2005
1. OCCUPANCY		**Fast Food Restaurant**		**Fast Food Restaurant**
2. BUILDING CLASS & QUALITY	Sec. 13, P. 17	"C" Class, Good Quality	Sec. 13, P. 17	"C" Class, Good Quality
3. EXTERIOR WALLS		Masonry		Masonry
4. NO. OF STORIES & HEIGHT PER STORY		1 Story, 12' Ceiling Height		1 Story, 12' Ceiling Height
5. AVERAGE FLOOR AREA		4,037 SF		4,037 SF
6. AVERAGE PERIMETER		294'		294'
7. AGE & CONDITION		19 / Good		20 / Good
8. BASE SQUARE FOOT COST	Sec. 13, P. 17	**$107.43**	Sec. 13, P. 17	**$116.34**
SQUARE FOOT REFINEMENTS				
9. HEATING, COOLING, & VENTILATION	Sec. 13, P. 15	$2.40	Sec. 13, P. 15	$2.55
10. ELEVATOR		$0.00		$0.00
11. MISCELLANEOUS		$0.00		$0.00
12. TOTAL OF LINES 8 TO 10		**$109.83**		**$118.89**
HEIGHT AND SIZE REFINEMENTS				
13. No. STORIES MULTIPLIER		1		1
14. HEIGHT / STORY MULTIPLIER	Sec. 13, P. 38	1	Sec. 13, P. 41	1
15. FLOOR AREA-PERIMETER MULTIPLIER	Sec. 13, P. 37	1.079	Sec. 13, P. 40	1.079
16. COMBINED HEIGHT & SIZE MULTIPLIER		**1.079**		**1.079**
FINAL CALCULATIONS				
17. REFINED SF COST		$118.51		$128.28
18. CURRENT COST MULTIPLIER	Sec. 99, P. 3	1.09	Sec. 99, P. 3	1.09
19. LOCAL MULTIPLIER	Sec. 99, P. 8	1.04	Sec. 99, P. 8	1.03
20. FINAL SF COST		$134.34		$144.02
21. AREA		4,037		4,037
22. Line 20 x Line 21		$542,327		$581,419
23. LUMP SUM (FOR YARD IMPROVEMENTS)		$25,000		$25,000
24. REPLACEMENT COST NEW BUILDING		$567,327		$606,419
25. PHYSICAL DEPRECIATION %	Sec. 97, P. 15	26%	Sec. 97, P. 15	28%
26. FUNCTIONAL OBSOLESCENCE %		10%		10%
27. DEPRECIATED BUILDING COST		$377,840		$392,960
28. DEVELOPER'S PROFIT		10% of Replacement Cost		10% of Replacement Cost
29. DEPRECIATED COST + DEVELOPER'S PROFIT		$434,573		$453,602
30. LAND VALUE		$450,000		$475,000
31. TOTAL INDICATED VALUE VIA COST APPROACH		$884,573		$928,602
32. TOTAL INDICATED VALUE – ROUNDED		**$885,000**		**$930,000**

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: Mark Lutter, Northeast Property Tax Consultants, 14 Roy Drive, Hudson, NH 03051, representative for the Taxpayer; and Chairman, Board of Selectmen, Town of Goffstown, 16 Main Street, Goffstown, NH 03045.

Date: 08/11/08

Anne M. Stelmach, Clerk