DOHERTY, WALLACE, PILLSBURY AND MURPHY, P.C.

APPELLATE TAX BOARD UPDATE

A periodic report for property owners, appraisers, assessors and attorneys

THE YEAR 2014 IN REVIEW

The year 2014 was a busy one at the Appellate Tax Board, not just in terms of the 51 "Findings of Fact and Reports" in real estate tax cases but particularly in terms of the number of "big ticket" cases among those decisions. These covered properties such as shopping centers, massive office complexes, research and development facilities and other commercial developments – even a couple of cell towers. There were also decisions on more varied matters such as arm's length sales, "super adequacy," a solar generating facility and even the exempt status of a house in a cemetery. About two dozen of those decisions have been selected for coverage in this issue of our annual Update.

YEAR OF THE CAP RATE

When assessors and appraisers take pencil in hand to value property using the income approach, the final dramatic step is arriving at a capitalization rate and then applying that percentage to net operating income. In one push of the button, fair cash value appears on the screen. As readers of the Update may recall, in a typical year the ATB may issue three or four – if any – decisions which reflect deliberations on the appropriate "cap rate." In 2014 the ATB issued no less than 16 "Findings of Fact and Reports" which included the Board's prescription of the cap rate plus other ingredients in the fair cash value computation. These cases typically involved high value properties and featured dueling experts and owners and assessors in locked combat – Caesar's Gallic Wars at the ATB. These decisions from 2014 form an essential library for studying ATB methodology.

Getting loaded. The most highly valued property in one of these cases was the multi-building complex (about 379,000 square feet) in Sun Life Assurance v. Wellesley Assessors (December 8, 2014) assessed for about $88.6 Million and $76.5 Million for Fiscal Years 2010 and 2011. The Sun Life case was a laboratory for some true "inside baseball" analysis involving "loaded" and "unloaded" cap rates. An increase in expenses obviously reduces net operating income and can ultimately reduce fair cash value. The same effect can result from increasing the cap rate. Thus the owner's expert in Sun Life increased expenses by including reserves for replacements, leasing commissions and tenant improvements. Since that step had the effect of reducing fair cash value, the owner's expert offset that result by reducing ("unloading") his cap rate by a half percent, from 8% to 7.5%. He arrived at an FY2010 fair cash value for the property of about $67 Million.

David J. Martel, Esquire, Editor
Rosemary Crowley, Esquire, Associate Editor
Doherty, Wallace, Pillsbury and Murphy, P. C.
One Monarch Place, Springfield, Massachusetts 01144
Telephone: (413) 733-3111 – Email: dmartel@dwpm.com

587567.1

The assessors' expert also treated those reserves and allowances as expenses but started with a "loaded" cap rate of 7.5% and an unloaded rate of 6.37%, over one percent less than the unloaded rate of the owner's expert, thereby arriving at a higher fair cash value. The assessors' expert arrived at his unloading factor by calculating the percentage change that would be made to NOI by deducting the reserves and allowances, an approach the ATB said was "amply supported by empirical data." On the other hand, the owner's expert simply unloaded his cap rate by a half percent, without further explanation. This approach was not adequately justified in the eyes of the ATB.

The difference of opinion in fair cash values for the property for FY2010 (the owner claimed about $67 Million; the assessors, about $98 Million) wasn't just the result of differing cap rates, although that's where the inside baseball twist appeared. The owner claimed NOI was about $5.7 Million while the assessors suggested $8.4 Million was appropriate. The ATB settled on $6.6 Million. The ATB then adopted the assessors' suggested unloaded cap rate and concluded fair cash value for FY2010 was $89.1 Million, (slightly more than assessed value), and $73 Million for FY2011, (slightly under the assessed value).

In another big ticket case, both experts – with approval of the ATB – used "loaded" cap rates, i.e. they deducted expenses for leasing commissions, tenant improvements and capital reserves to arrive at NOI but left cap rates unchanged. Both experts used 8% for the two years in question (FY2011 and FY2012). The case was <u>Technology Park, LTD v. Billerica Assessors</u> (December 18, 2014) and involved a 400,000 SF, Class A office/research and development facility assessed for about $39 Million but found to be overvalued by $4 Million and $2.5 Million respectively in the two years. This case is now before the Appeals Court.

Other lessons on cap rates were to be learned from <u>Behrakis, Et Al, Trustees v. Bourne Assessors</u> (September 26, 2014). This case involved a multi-tenant shopping center. The assessors' expert witness relied exclusively on the common "band of investment" technique and, despite market fluctuations, used essentially the same cap rate for all four years (FY2010-FY2013). On the other hand, the owner's expert used a number of different sources, including established national rates for strip-mall shopping centers as well as the band of investment methodology. In addition, the owner's expert showed variations in the cap rate: 11%, 11.5%, 10.5% and 10% over the four years. Nevertheless, the ATB gave "limited weight" to the rates suggested by the owner's expert, primarily because the ATB disagreed with his conclusion that the property was "distressed" and represented a high risk investment warranting an elevated cap rate. The ATB settled on rates of 9.5%, 11%, 10.5% and 9.5% for the four years. Deferred maintenance and functional utility issues also warranted an elevated cap rate (10%) in <u>Market Forge Industries, Inc. v. Everett Assessors</u> (April 17, 2014), an FY2011 case involving an old multi-building industrial complex assessed for about $4.6 Million. The ATB found overvaluation of about $800,000.

APPELLATE TAX BOARD UPDATE

A FEW MORE FINE POINTS

Capital Improvements. A couple other "fine points" emerged from last year's cache of ATB decisions. Campanelli Westfield, LLC v. Quincy Assessors (March 10, 2014) involved a 117,000 SF office building on six acres of land valued at $16 Million for both FY2010 and FY2011. The owner's case included testimony from a construction expert about necessary future repairs to the building. The owner's expert proposed to deduct $447,000 for these costs "below the line," i.e., after the initial calculation of fair cash value. The ATB ruled that there was no justification for this one-time deduction of the capital expenditure which should instead have been amortized over time. The ATB suggested that an appropriate accounting for the roof problem would be a replacement reserve of $.25 SF in the NOI calculation. This step "above the line" had the effect of reducing value by about $371,000. Although the ATB also made the point that it would be inappropriate to take the capital deduction for both years at issue, the ATB did include its $.25 SF reserve for both years. Nevertheless the ATB (using a 7.9% cap rate) did find overvaluation of about $1 Million in FY2010 and $3.3 Million in FY2011.

Similarly, the ATB held that it was inappropriate to deduct for the roof replacement cost in Quincy Office Investors, LLC v. Quincy Assessors (November 4, 2014). This case involved a 118,325 SF office building which the ATB valued at $14.1 Million for FY2011 and $15.1 Million for FY2012 (well below assessed value). As part of its decision, the ATB found the $300,000 cost of the new roof should not be deducted as an expense but rather should be accounted for by "loading" the cap rate with a replacement reserve.

EGI vs. PGI. Another fine point, again taken from the deep recesses of inside baseball, came up in Main Street Property, Inc. v. Wayland Assessors (February 21, 2014). The case involved two multi-tenant retail/office buildings totaling about 44,000 square feet on about five acres of land and assessed for about $4.7 Million. The ATB noted a flaw in one of the calculations of allowable expenses related to the property. Although a 3% reserve for replacement was appropriate, that percentage should have been applied to "effective gross income" (gross income less vacancy and credit losses) not "potential gross income" (rentable area times the rent rate). Further, the ATB noted that the expenses of $4 SF should be based on the rentable area not the gross square footage of the building. One further feature of the case involved a supermarket as the anchor tenant. The determination of the appropriate rent to use for that tenant in the fair cash value computations resulted in a good deal of discussion on the part of both the owner and the assessors as well as the ATB. The ATB ultimately concluded $13 SF was right for the supermarket, $21 SF for the other retail space and $23 SF for the office. The ATB upheld the assessed value in both years.

Triple Net Leases. Several of the 2014 cases involved leases where virtually all the expenses were borne by the tenant so that, in calculating NOI, the owner was not allowed to deduct the usual expenses. Nevertheless, the owner did have certain costs which reduced its bottom line as shown in Bodwell Extension, LLC v. Avon Assessors (January 31, 2014) involving a 74,000 SF warehouse-style building valued at about $3.3 Million in both FY2011 and FY2012. There the ATB noted that it was appropriate to show deductions for a management fee, reserves, insurance fees, payroll expenditures, repair charges and costs for the maintenance of systems and the structure. The ATB allowed a 14% deduction from effective gross income to recognize these costs and concluded the property was modestly overvalued in both years.

CELL TOWERS

Two cases provided guidance on valuation of cell towers. The case with a more expansive analysis was CSHV Concord, LLC v. Billerica Assessors (December 2, 2014) which spanned FY2010-2012. There the owner's expert did not separately value the cell tower in valuing the entire property, a 343,000 SF office building on 44 acres of land, assessed for about $35 Million in FY2010. On the other hand, the assessors' expert took the gross income from the cell tower (about $235,000 per year), and deducted 25% for expenses. Since the tower was in an "excellent location" he used an 8% cap rate which he testified was at the lower end of the 8% to 12% rate appropriate for cell towers in general. His value for the cell tower came to about $1.6 Million for each of the three years which he added to the value of the land and buildings. The ATB adopted this approach in its decision which found overvaluation of the entire parcel from about $1 Million to $2.5 Million over the three years.

The tower in Fortifiber Corp. v. Attleboro Assessors (September 8, 2014) was of considerably less value. The gross income was only $20,700, reduced by the owner's expert to an NOI of about $20,200 after reductions for vacancy (1%) and management and administrative costs (1.5%). The ultimate value came to only $144,000 using a healthy 12% base cap rate to account for the property's low quality and non-institutional grade. The ATB adopted this entire approach.

SUPER ADEQUATE

"Super adequacy" is not a state that owners usually strive to achieve. In two recent cases, a couple of taxpayers did go for that lofty status in their attempts to reduce the values of their properties. Super adequacy, in the words of the ATB and The Appraisal Institute, is "a type of functional obsolescence caused by something in the subject property that exceeds market requirements but does not contribute to value an amount equal to its cost." In Dinno, Trustees of D&C Trust v. Weston Assessors (May 20, 2014) the Dinnos argued that their property was actually super adequate because it had been overbuilt with wider hallways and larger rooms to meet the needs of their handicapped daughter. The property was purchased in 2007 for $1,108,250. The existing structure was torn down and the new home, complete with wine cellar, tasting room, home theatre and other essentials, was built with wetland and drainage easements. At 95% completion, the property was valued at $3,651,800 for FY2011. An examination of the otherwise fairly uniform neighborhood convinced the ATB that the home was likely over improved. That consideration, together with the comparable sales analysis of the taxpayer's expert, convinced the ATB that the taxpayers met their burden and that reductions in value of $322,000 for FY2010 and $438,000 for FY2011 were in order.

In the second case, Frei v. Holland Assessors (October 24, 2014), the taxpayer's super adequacy argument focused on a secondary dwelling being built above a one-car garage. The secondary dwelling supplied full views of a reservoir through large windows. Built into a hill, the dwelling lacked a kitchen but opened to an outdoor patio and grilling area. The taxpayer attempted to cherry pick the secondary dwelling off the property card and argue that it was super adequate since it was an accessory building, not truly a dwelling. As such, the taxpayer thought the structure to be super adequate. In the eyes of the ATB, the taxpayer failed his burden by focusing on one portion of the property rather than the whole.

SOLAR SUPPLY

In Forrestall Enterprises, Inc. v. Westborough Assessors (Dec. 4, 2014) the taxpayer sought exemption under Clause 45th of G.L. c. 59, sec. 5 for solar equipment that fed electricity directly to the electrical grid of National Grid which in turn provided energy credits to properties owned by the taxpayer in Westborough. The assessors argued that to qualify for the exemption, the equipment needed to furnish actual electrons, not credits, directly to the energy-using properties on the same or contiguous property. The ATB found that Clause 45th required that, to be exempt, personal property needed to be: (1) a solar powered device; (2) used as a primary or auxiliary power system to supply energy; and, (3) used to supply the energy needs of property that is subject to Massachusetts property tax. The case turned on the word "supply." The ATB found that the solar panels supplied energy to the properties whether that supply was in the form of credits or actual electrons. With this distinction lost, the DOR's policy requiring that the supplied properties be on the same or a contiguous parcel no longer made sense. Note, however, that this decision does not affect the taxability of solar equipment used to supply public properties pursuant to municipal solar power purchase agreements. Such equipment is taxable because it does not meet the third requirement of the test articulated by the ATB.

LIVING WITH THE DEAD

In West Beit Olam Cemetery Corp. v. Wayland Assessors (Nov. 10, 2014) a property contiguous to a cemetery and owned by the cemetery failed to qualify for full exemption under G.L. c. 59, sec. 5, Clause 12th because the home on the property was not used exclusively in the administration of the cemetery, but rather provided a home to the family living there. It all started when the owners of the original cemetery wanted to provide for future expansion and needed new road access for another cemetery it owned. For expansion purposes, it purchased contiguous property with a single family residence. To create the needed new access, the cemetery purchased yet another property from a Mrs. Howland, demolished her house and built a road over the property. As part of the purchase, the cemetery owner agreed to allow Mrs. Howland and her family to live in a home on the planned expansion property rent free as a caretaker for seven years. While the only contractual duty placed on Mrs. Howland under the cemetery caretaker agreement was to open and shut the gates to the cemetery each day, she testified that she also patrolled the cemetery daily, wiped down benches, placed flags and reported problems. Mrs. Howland performed these tasks while retaining her part-time job as a receptionist in a nearby veterinary hospital. The ATB found that Mrs. Howland's activities did not constitute extensive maintenance, landscaping or administrative tasks. Rather, Mrs. Howland's family used the property as its primary residence with the exception of 11,466 square feet of property carved out in the agreement for the exclusive use of the cemetery. The ATB decided that, while the carved out area was exempt, the remainder of the property was not. The case is now before the Appeals Court.

APPELLATE TAX BOARD UPDATE

WHEN A SALE IS NOT A FAIR CASH VALUE SALE

In 2014 the ATB dealt with a number of scenarios involving non-arm's length sales. In Simov v. Gardner Assessors (Sept. 17, 2014) the taxpayer purchased the property from a bank for $114,400 on October 1, 2009 and then on June 23, 2010 obtained a $152,200 mortgage on the property from another bank. The assessors valued the property at $181,500 as of January 1, 2011. The taxpayer asserted a value of $124,000 based in part on the bank's appraisal report in connection with the mortgage (although the appraiser did not testify) and in part on an owner-generated 2009 and 2010 spreadsheet of sales in Gardner. The ATB found that the bank sale was inherently suspect and that the taxpayer had failed to present evidence to rebut the presumption of compulsion on the bank's part to dispose of the property. The appraisal report without testimony from the appraiser was found to be unsubstantiated hearsay. The spreadsheets failed to establish comparability through adjustments for "size, time of sale, location [or] condition." In sum, the taxpayer failed his burden of overcoming the legal presumption in favor of the assessed value.

In Morrissey & Maurer v. Easton Assessors (Jan. 16, 2014) the same evidence offered as in Simov – bank sale, appraisal without an appraiser and non-adjusted comparables – led to the same result: the taxpayers failed their burden.

The deficient sales in those cases are in contrast with the sale of a fully-restored, classic eight-fireplace home in Lane v. Dover Assessors (December 12, 2014). The sale price was about $4.4 Million, more than its assessed value, and took place 18 months before the January 1, 2011 valuation date for FY2012. Interestingly, the owner's expert claimed that his clients "extremely overpaid for the property," a lapse which he speculated might have been due to "various personal reasons." In the eyes of the ATB, there was "no credible evidence" to support those claims. Property values in Dover, the ATB found, had been stable in the period between the sale and the valuation date and in this case there was no evidence of compulsion or other factors to support the absence of arm's length conditions.

In Hiser v. Windsor Assessors (July 2, 2014) the ATB revisited a property for FY2012 that it had already valued for FY2010, bringing into play the statutory presumption (Chapter 58A, Section 12A) that the FY2010 value was correct for FY2012. The taxpayer claimed the value should be lower than the ATB's previous value and the assessors thought higher. Both failed their burden. The assessors relied on one comparable sale and applied its price per square foot to the subject. The ATB didn't find a basis for comparability between the two properties. The taxpayer offered information on three supposed comparable sales. Besides showing that the taxpayer failed to make adjustments from the comparables to the subject, the assessors established that two of the comparables were not arms-length sales. The property's assessed value was restored to its FY2010 value.

Finally, in Sliski v. Lincoln (Sept. 17, 2014), the taxpayers attacked the valuation of their residential, agricultural and excess undevelopable properties. It was the valuation analysis of the excess property that raised arm's length concerns. The taxpayers pointed to their $100 purchase price as evidence of value. The assessors were able to show that the property had never truly been exposed to the market. The previous owners had originally wanted to sell to a developer, but that sale fell through. After the deal fell through, the previous owners offered it only to their neighbors, the Sliskis. The ATB agreed with the assessors that the sale was not at arm's-length because the property had not been exposed to the market and upheld the assessed value. The case is now before the Appeals Court.

TEAR DOWNS

In Tufankjian v. Whitman Assessors (Oct. 28, 2014) the value of land with a "tear down" house was at issue. The taxpayer presented evidence that the house was uninhabitable in light of the caving foundation, boarded windows and condemnation by the fire department. The appraisal report and appraiser were, however, found not credible. The assessors established that the appraiser's three comparables were not at arm's length since two were bank sales and the third was sold in the context of a divorce. Finally, the taxpayer was unable to provide credible evidence of demolition cost. In the end, the ATB reduced the property value by the value assigned to the structure (with no deduction for the tear down cost), leaving only the land value to be taxed.

Rose Boston, LLC v. Brookline Assessors (Dec. 4, 2014) also involved a dilapidated home which had been condemned and deemed uninhabitable by the fire department. The taxpayer, however, did not know when it had been condemned in relation to the valuation date. Therefore, the ATB did not find credible the taxpayer's assertion that the property was valueless and instead accepted the assessors' adjustments for the condition of the building. The taxpayer offered expired listings of supposedly comparable properties which the ATB found were not comparable and which were fundamentally dissimilar to the subject property.

FREE FLYING

In Airflyte, Inc. v. Westfield Assessors (Oct. 1, 2014), the ATB examined another exception to the general rule that government-owned property used in connection with a for-profit business is subject to local property tax payable by the entity using the property. An exception is found in the General Laws, Chapter 59, section 2B which precludes the taxation of government-owned property where its "use, lease or occupancy … is reasonably necessary to the public purpose" of certain properties that are available to the general public, in this case the Westfield-Barnes Regional Airport. Airflyte, Inc., has served as a Fixed Base Operator or "FBO" for the airport for over 20 years providing services such as aircraft fueling, hangaring and parking at the airport. Airflyte provided its services to anyone who sought and paid for them. The true question was the relationship of the services to the public purpose for which the property was used and had nothing to do with a leasing entity's profit or non-profit status. The ATB concluded that the services were related to the public purpose of the airport and therefore the property used in rendering those services should be exempt.

RV PARK

The ATB closed out the year with a rarely-seen decision involving a recreational vehicle resort. MHC Gateway to Cape Cod LLC v. Rochester Assessors (December 30, 2014). The resort was located on about 79 acres of land and included 194 developed RV sites, 26 cabins, affiliated amenities and various other buildings for administration, recreation and bathroom facilities. The complex was assessed for about $6.3 Million for Fiscal Year 2011. The RV sites offered hookups for water, sewer and electricity and made available the various recreational and other amenities to those who park their rigs. Rental rates ranged from about $2,000 per site for one of the 30 six-month seasonal rentals and $30 per day for the remaining "transient" sites. The cabins rented for $2,140 per season or $45 per day. The owner's expert witness relied primarily on the income approach and computed the effective gross income at about $535,000 per year and expenses of about $275,000, resulting in NOI of about $260,000. The expert used a cap rate of 8.25% (plus a tax factor) to arrive at a value of about $2.7 Million. The ATB agreed with the owner's computation except for the cap rate where the ATB favored 7.8%, resulting in fair cash value of about $2.9 Million, well inside the assessed value.

ON HIGHER AUTHORITY

Last year's Update reported the ATB's decision upholding the tax-exempt status of South Station in Boston thanks to a special statute that granted an exemption from local taxes to properties owned by the MBTA, even when those properties were leased to private parties. The Appeals Court upheld the ATB's decision in Beacon South Station Associates v. Boston Assessors, 85 Mass. App. Ct. 301. As also noted in last year's Update, the case is now of purely academic interest as a result of new legislation which provides that MBTA property which is leased, used or occupied in connection with a business conducted for profit is taxable to the lessees, users or occupants as if they were the owners.

Last year the Update also reported the ATB's denial of a charitable exemption in Community Involved in Sustainable Agriculture, Inc. v. Deerfield Assessors. The goals of the non-profit entity included enhancing the quality and sustainability of agricultural products. The ATB particularly took note of CISA's objectives to establish new and strengthen existing markets for farmers, making the entity's "dominant purpose" the promotion of locally grown food with only incidental benefit to the public. The Appeals Court (86 Mass. App. 1119) disagreed and concluded that CISA "more closely resembles a traditionally charitable organization than it does a commercial enterprise." The entity's work in "increasing food security and developing sustainable local farming" did in fact constitute "charitable activities that benefit the general public."

Finally, In New England Forestry Foundation, Inc. v. Hawley Board of Assessors, 468 Mass. 138 (2014) a/k/a "NEFF v. Hawley," the Supreme Judicial Court declared that land conservation is a traditional charitable purpose and granted a Chapter 59, section 5, Clause Third charitable exemption to NEFF for the 122 acres of forest it owned in the Town of Hawley. Previously, the land had been classified as agricultural and for that reason enjoyed a substantially reduced tax under Chapter 61. The key fact in this case was that NEFF held the land passively with the intent of conducting revenue-generating tree cuts every 10 to 12 years as required by its Chapter 61A mandated forest management plan. In addition, NEFF did not encourage public access. The Court found that NEFF met the "occupy" requirement of Clause Third by not precluding public access and by conserving forestland which sometimes requires land simply be left in its "natural and pristine condition." The Court acknowledged the importance of distinguishing between land held in an undevelopable state for private purposes as contrasted with charitable conservation purposes. Assessors are to identify "true" conservation organizations and to ensure that lands are not being held tax free as private clubs or private property land buffers. In the interest of full disclosure, your associate editor defended the appeal in the Supreme Judicial Court on behalf of the Hawley Assessors.

APPELLATE TAX BOARD UPDATE

2014 CAPITALIZATION RATE SURVEY			
CASE	TYPE OF PROPERTY	YEAR	ATB % RATE**
Sun Life v. Wellesley	Office	2010	6.37
		2011	6.60
Fowler v. Newton	Office/Industrial	2011-2012	7.5
Quincy Office v. Quincy	Office	2011	7.6
		2012	7.5
MHC Gateway v. Rochester	RV Camp Resort	2011	7.8
Campanelli Westfield v. Quincy	Office	2010-2011	7.9
Technology Park v. Billerica	Office/R & D	2011-2012	8.0
CSHV Concord v. Billerica	Office	2010	8.0
		2011	8.3
		2012	8.0
	Cell Tower	2010-2012	8.0
1776 Plaza v. Sudbury	Retail/Restaurant	2012-2013	8.5
Bodwell Extn. v. Avon	Warehouse	2011-2012	9.04
Aramark v. Norwell	Office/Manufacturing/Warehouse	2010	9.25
53 Millbrook v. Worcester	Industrial	2010	9.5
		2012	9.25
Main Street v. Wayland	Retail/Office	2010	9.5
		2011	9.0
		2012	8.5
Belmont Plaza v. Westborough	Office/Retail	2011	9.5
		2012	9.25
Behrakis v. Bourne	Shopping Center	2010	9.5
		2011	11.0
		2012	10.5
		2013	9.5
Market Forge v. Everett	Industrial	2011	10.0
Fortifiber v. Attleboro	Office/Warehouse/Industrial	2012	12.0

**Capitalization rates do not include a tax factor.