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| NO. CV 04 0104632S | : | SUPERIOR COURT |
| MIDDLETOWN OXFORD LIMITED PARTNERSHIP | : | JUDICIAL DISTRICT OF |
| v. | : | MIDDLESEX AT MIDDLETOWN |
| CITY OF MIDDLETOWN, ET AL. | : | DECEMBER 11, 2006 |

**MEMORANDUM OF DECISION**

The plaintiff, Middletown Oxford Limited Partnership (Middletown Oxford), brings this real estate tax appeal challenging the assessor's valuation of the plaintiff's property known as Northwoods Apartments located at 1 Dove Lane and Westlake Drive in the city of Middletown (city) for the Grand Lists of October 1, 2003, October 1, 2004 and October 1, 2005.

On the revaluation year of October 1, 2002, the city's assessor valued the subject apartment complex at $22,519,200. However, the plaintiff claims that the value of the subject property, as of October 1, 2002, was $20,700,000.

The subject property contains 17.37 acres of land located off East Street, south of Route 372 and east of Interstate I-91. The site contains thirteen, three-story walk-up, garden-style apartment buildings with an inground pool and a common building housing a rental office, fitness center and common room. The site slopes downward from road grade and is rolling and wooded throughout. There are two types of buildings on the site:

four standard three-story buildings and nine hillside buildings. The hillside buildings have a saltbox roof, half of the first floors are at grade with two apartments and the rear of the first floors are below grade crawl space.

The apartment complex was constructed in 1986 containing a total of 336 units. More specifically, 186 units are one-bedroom units including 114 units spanning 719 square feet and 72 units spanning 819 square feet. 150 units are two-bedroom units including 48 one-bathroom units spanning 837 square feet and 102 two-bathroom units spanning between 969 and 990 square feet.

All units include a fully-applianced kitchen, washer and dryer, separate gas furnace and central air and either a wood deck or concrete porch. 160 units have a fireplace in the living room. The subject property has electricity, telephone, water, sewer, gas and cable. The tenants pay directly for gas and electricity which includes the heat, air conditioning and all-plug electricity.

The roof of the subject property was replaced in 2001. The site improvements consist of paved parking, concrete walkways, landscaping, crushed stone walking paths, wood plank retaining walls and a play area for children. There is a total of 543 parking spaces consisting of 25 carports containing 108 parking spaces and 435 open paved parking spaces. The inground pool is located behind the common building surrounded by a fenced-in patio.

Both appraisers, Robert H. Silverstein (Silverstein) for the plaintiff and Sean T. Hagearty (Hagearty) for the city, concluded that the highest and best use for the subject property as of the date of the last revaluation was its continued use as an apartment complex. Both appraisers used the income approach and sales approach to value and both declined to use the cost approach. Silverstein concluded that the subject property, as of October 1, 2002, had a final fair market value of $20,700,000. On the other hand, Hagearty concluded that the final fair market value of the subject property, as of October 1, 2002, was $25,500,000.

The process for determining fair market value using the income approach begins with the potential gross income of the subject and, after deducting the vacancy/collection loss amount, concludes with the effective gross income (EGI) calculation. The next aspect of the process is to determine the total expenses attributed to the operation of the subject and deduct these expenses from EGI to arrive at the net operating income (NOI) of the subject. The final stage of the process is to determine the capitalization rate plus the tax adjusted capitalization rate to arrive at an overall capitalization rate. The NOI of the subject is then divided by the overall capitalization rate to arrive at the fair market value of the subject. Thus the income approach is determined by the property's earning power, represented by NOI, based on the capitalization of this earning power. See The Appraisal of Real Estate (12th Ed. 2001) p. 50. Simply stated, the income capitalization approach is based on the present worth of anticipated future benefits and the discounting of these benefits. Id., 96.

Both appraisers, using the income capitalization approach, arrived at a similar EGI: Silverstein calculated an EGI of $3,613,961 while Hagearty calculated an EGI of $3,659,796. However, the vast difference in the appraisers' final valuation figures stems from a $259,129 difference in the appraisers' total expenses calculation: Silverstein calculated total expenses in the amount of $1,332,923 whereas Hagearty calculated total expenses in the amount of $1,073,794.

Silverstein and Hagearty also differed on the capitalization rate to employ in the income approach. Under the simple band of investment method, Silverstein arrived at an overall capitalization rate of 9.04% to which he added an effective tax rate of 1.98%, for a total tax adjusted capitalization rate of 11.02%. Hagearty based his capitalization rate upon sales of large apartment complexes throughout Connecticut between 1999 and 2003, with the overall capitalization rates ranging from approximately 7.8% to 9.7%. Hagearty referred to the Korpacz Real Estate Investor Survey (hereinafter the Korpacz survey) for the third quarter of 2002, showing institutional grade property with an initial capitalization rate between 6.50% and 10.00% and non-institutional grade property with an initial capitalization rate between 8.50% and 12.00%. Hagearty considered the subject property closer to the institutional grade property of the Korpacz survey. Based on this analysis, Hagearty arrived at an overall capitalization rate of 10.25%, including the 1.98% add-on for the tax factor.

Silverstein arrived at NOI in the amount of $2,281,038 ($3,613,961 EGI - $1,332,923 total expenses). Silverstein then applied a tax adjusted capitalization rate of 11.02% to determine that the fair market value of the subject was $20,700,000. Hagearty arrived at NOI in the amount of $2,586,002 ($3,659,796 EGI - $1,073,794 total expenses). Hagearty then applied a tax adjusted capitalization rate of 10.25% to determine that the fair market value of the subject, based on his income capitalization analysis, was $25,230,000. Given the similarity in both appraisers' EGI figures and the disparity in their findings of expenses and capitalization rate, it becomes necessary to analyze their bases for arriving at these calculations.

For the most part, the disparity between Silverstein and Hagearty centers on the following operating expense categories: management, payroll and maintenance/repairs.

Silverstein computed the amount of $180,698 for management by taking 5% of his $3,613,961 EGI figure and explained his analysis as follows: "A management fee for a rental apartment of this size typically averages 5% of effective gross income (EGI), and is considered an appropriate rate for Northwoods. This property is management intensive, with a tenant turnover of more than 200 units per year." (Plaintiff's Exhibit 1, p. 65.)

In contrast, Hagearty computed the amount of $109,794 for management by taking 3% of his $3,659,796 EGI figure and stated that the payroll category included an "allowance for manager's salaries". (Defendant's Exhibit A, p. 35.) Hagearty computed

$250,000 in payroll expenses based upon his finding a stabilized cost of 6.8% of EGI and stated that "[p]ayroll expenses were generally consistent for the years 2001 through 2003. Expenses here include manager salary, administrative and maintenance salaries, benefits and commissions. The exterior ground maintenance expenses have been fairly consistent as have the administrative and advertising expenses." (Defendant's Exhibit A, p. 32.)

Silverstein calculated $325,257 in payroll expenses based upon his finding a stabilized cost of 9% of EGI. It was Silverstein's analysis that "[p]ayroll costs consistently ranged from 5.8% to 6.1% of EGI, or $628 to $652 per unit; while IREM [Institute of Real Estate Management] median is 12.5% or $1,219 per unit. This is well below the norm for comparable properties, and is due to the unique management situation at the property. The management company, AIMCO, manages many hundreds of units throughout the region, thereby creating economies of scale not normally found. The five expense comparables have costs ranging from 2.9% to 13.7%, or $164 to $1,117 per unit. The low rate is for a property with a repair expense of 18.4%, suggesting that maintenance payroll is included in the maintenance and repair budget. Excluding this property, the range is 9.3% to 13.7%, or $756 to $1,177 per unit. A stabilized cost of 9% of EGI is estimated for the subject, which is equivalent to $968 per unit." (Plaintiff's Exhibit 1, p. 65.)

Silverstein calculated general maintenance and repairs at approximately $235,000 and contract services at $105,000 based upon the following analysis:

> "Contract services have ranged from 2.6% to 2.9% of EGI; a stabilized rate of 2.9% is estimated.
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> "Repairs and Maintenance can vary widely from year to year. To include turnover expenses, these costs have ranged from $415 to $844 per unit, or 3.9% to 7.8% of EGI. The IREM median is $1,055, or 10.8% of EGI. The five competitors have costs ranging from a low of 6.5% to a high of 18.4%. Excluding the highest percentage, which is for a project with a very low payroll, suggesting that maintenance payroll is included in this category, the comparables range from 6.5% to 9.2%, or $636 to $817 per unit. Since Contract Services are included at 2.9% for the subject, and relate mostly to this category, a stabilized cost of $700 per unit, to include grounds, common area, and building maintenance is estimated for the subject, which is equivalent to 6.5% of EGI. The sum of this and contract services is $963 per unit, or 9.4% of EGI. Considering the amount of common areas, paving, grounds, pool, clubhouse, retaining walls, and the average turnover of over 200 units per year, which requires painting, recarpeting, and general maintenance and repairs associated with turning over a unit to a new tenant, this is a reasonable market supported average annual cost."

(Plaintiff's Exhibit 1, pp. 65-66.)

The difference in the three major categories of operating expenses as determined by Silverstein and Hagearty center on the size of the subject and the scope of the activities conducted at the subject property. As Silverstein points out, an annual turnover of 200 units out of 336 total units has a significant impact on the management, general maintenance and repair of the subject apartment complex. Furthermore, Silverstein takes into consideration the fact that AIMCO manages the subject. AIMCO manages hundreds of units throughout the region and is able to have lower operational costs due to an economy of scale when compared to the rental market.

Although Hagearty conducted a good analysis of the operational costs, Silverstein's analysis and conclusions appear to be more in line with the size of the subject and the market for rental units. Taking Hagearty's finding of EGI in the amount of $3,659,796 and deducting Silverstein's operating expenses in the amount of $1,332,923, results in NOI of $2,326,873.

Hagearty used an overall capitalization rate of 10.25% that included a combined tax factor adjustment of 1.98%, whereas Silverstein selected an overall capitalization rate of 11.02% that included a combined tax factor adjustment of 1.98%. As an example, the difference between the appraisers' calculations of the overall capitalization rate can be shown by dividing NOI in the amount of $2,326,873 by Silverstein's capitalization rate of 11.02%, which results in a value of $21,115,000, as well as by Hagearty's capitalization rate of 10.25%, which results in a value of $22,701,200.

Silverstein's capitalization rate was based on the capitalization rate extraction from five sales ranging between 8.56% and 9.75%. Silverstein considered the Korpacz survey and further considered the band of investment approach using an 80% loan-to-value ratio with the mortgage constant at .0930 to equal .0744 and the 20% equity investment with the equity dividend rate at .0800 to equal .0160 for an overall capitalization rate of .0904. Adding the 1.98% tax factor results in a final capitalization rate of 11.02%.

Hagearty also considered the band of investment approach but employed a mortgage component of 75% loan-to-value ratio and an equity component of 25% to determine a capitalization rate of 10.25% with the following comment: "This reflects the midpoint of the range indicated by the band of investment analysis using current market parameters for the equity and debt positions (8.20%) and that indicated by the local market capitalization rates and investor surveys (8% to 8.5%), plus the 1.98% add-on for the tax factor." (Defendant's Exhibit A, p. 40.) Hagearty's 75% loan-to-value ratio better reflects the market than Silverstein's 80% loan-to-value ratio.

After review of the range between Silverstein and Hagearty in the development of the capitalization rate and the use of comparable sales, the Korpacz survey and the band of investment approach, an overall capitalization rate of 10.48% (a capitalization rate of 8.5% plus the 1.98% add-on for the tax factor) is more in line with the appraisers' input.

Under the income approach, NOI in the amount of $2,326,873 divided by 10.48% results in a finding of fair market value of the subject property, as of October 1, 2002, in the amount of $22,202,987 which is $316,213 less than the assessor's valuation of $22,519,200. This amount reflects a sales price of $66,080 per unit in comparison to Silverstein's $63,500 per unit value and Hagearty's $75,290 per unit value.

After analyzing the appraisers' selection of comparable sales, the court agrees with Silverstein that the sales approach is of little value given that neither of the appraisers' sales generate confidence that they are sales truly comparable to the subject for the purpose of this valuation.

Accordingly, because the court finds that the fair market value of the subject property, as of October 1, 2002 ,was $22,202,987, an amount lower than the assessor's valuation, judgment may enter in favor of the plaintiff sustaining its appeal, without costs to either party.

Arnold W. Aronson
Judge Trial Referee