NO. CV 08 4021519S	:	SUPERIOR COURT
HOME DEPOT USA, INC.	:	JUDICIAL DISTRICT OF
	:	NEW BRITAIN
v.	:	
CITY OF DANBURY	:	MAY 16, 2012

MEMORANDUM OF DECISION

The plaintiff, Home Depot USA, Inc. (Home Depot), brings this tax appeal challenging the assessor's valuation of its property located at 114 Federal Road in the city of Danbury (city) on the revaluation date of October 1, 2007.

The city's assessor set the fair market value of the subject property, as of October 1, 2007, at $22,254,800.

In the opinion of Home Depot's appraiser, John J. Leary (Leary), the fair market value of the subject property, as of October 1, 2007, was $14,000,000.

It was the opinion of the city's appraiser, Joseph P. Dondiego (Dondiego), that the fair market value of the subject property, as of October 1, 2007, was $21,000,000.[1]

Recognizing that both appraisers are substantially below the assessor's valuation, aggrievement on the part of the plaintiff has been established. The only issue remaining is

1 Dondiego's final market value conclusion of $21,000,000 was based on an assumed building area of 106,410 SF. At the stipulated gross building area (GBA) of 111,887 SF, Dondiego's value conclusion rises to $21,800,000. See defendant's 2/13/12 brief, pp. 1, 10.

what was the fair market value of the subject property as of October 1, 2007. See Davis v. Westport, 61 Conn. App. 834, 842, 767 A.2d 1237 (2001).

The defendant's post-trial brief, dated February 13, 2012, p. 2 (hereinafter referenced as defendant's 2/13/12 brief), adequately describes the subject property as follows:

"114 Federal Road (the 'Property') is an 8.99-acre parcel located on the west side of Federal Road. The Property is improved with a 111,887 square foot [SF] retail Home Depot store originally built in 1993 (including a 5,000 [SF] addition built in 2005).

"The Property is centrally located within the Federal Road corridor. Both appraisers agreed that Federal Road is a heavily traveled, recognized commercial strip. Leary described it as 'one of the most prime retail areas' in northern Danbury. As of the valuation date, this retail corridor included numerous automobile dealerships, a Stew Leonard's, Costco, Circuit City, Harley Davidson, and other large 'national tenants' - - i.e., retailers that are located throughout the country and focus on areas with strong demographics. Due to its attractiveness to shoppers and commercial investors, Federal Road is commonly known as the 'Miracle Mile.' DOT figures showed that peak hour traffic in front of the Property is 24,900 vehicles." (Citations omitted.)

The plaintiff's appraiser Leary further noted that the subject property is located "in the CG-20 zone on the west side of Federal Road, north of the Route 7 overpass and about 500 ft. south of Nabby Road. The site is improved with Home Depot Store No. 6209, a one-story, masonry and metal home improvement store constructed in 1993 (103,550 [SF]) and expanded in 2005 (8,337 [SF]) with a . . . 'GBA' of 111,887 [SF]. An enclosed outdoor garden center of 26,550 [SF] is attached to the east end of the building." (Plaintiff's Exhibit 5, p. 2.)

Home Depot has owned and occupied the subject property since 1993 without generating rental income. Rafael Garces, plaintiff's director of property tax, testified that Home Depot was the owner of the Home Depot store at the subject property, as of October 1, 2007, and through the pendency of this appeal.

Both appraisers were of the same opinion that the highest and best use of the subject property, as of the last revaluation date, was its current use as a home improvement store. Leary described the highest and best use as follows: "[T]he existing improvement contributes significant value to the overall property and the existing use as a home improvement store represents the highest and best use of the site and property." (Plaintiff's Exhibit 5, p. A-21.) Dondiego described the highest and best use as follows: "It is our opinion that the Highest and Best Use of the subject property as improved is as it is currently improved." (Defendant's Exhibit A, p. 18.)

Leary employed the cost approach and the income approach in his analysis to calculate a final valuation of the subject property at $14,000,000. He did not use the market sales approach because he did not find a sufficient number of comparable sales to make a proper comparison to the subject property. According to Leary, the April 2003 sale of the Fairfield Home Depot store is the only recent sale that was comparable to the subject. The Fairfield store consists of 100,744 SF of GBA on 9.19 acres of land and has direct highway visibility from I-95.

Using the cost approach, Leary concluded that the land value of the subject, as of October 1, 2007, was $6,300,000. See plaintiff's Exhibit 5, p. A-23. He found the value contribution of the site improvements to be $2,250,000 and the contribution of the building value, replacement cost new (RCN) less accrued depreciation, to be between $5,078,971 and $5,267,081, for a rounded value range indication of $13,600,000 to $13,800,000. See plaintiff's Exhibit 5, p. A-26. This value range resulted in GBA range of $121.55/SF to $123.34/SF.

Using the income capitalization approach, Leary formulated a net operating income (NOI) in the range of $1,190,198 and $1,208,380, which he capitalized at a range of 8.25% and 8.75% using the direct capitalization method. Leary arrived at a total value range of $13,600,000 to $14,600.000. See plaintiff's Exhibit 5, pp. A-28 and A-29.

The variance between Leary and Dondiego in the use of the three generally accepted approaches to developing an opinion of value (i.e., cost, market sales, income), is that Leary relied on the cost approach and Dondiego relied on the sales approach, with both appraisers further relying on the income capitalization approach. Both appraisers considered the use of the income approach even though the subject property was owner-occupied and did not produce rental income (which is a foundation in the use of the income approach). See PJM & Associates, LC v. Bridgeport, 292 Conn. 125, 139-40, 971 A.2d 24 (2009).

It is important to note Leary's comment that "[t]he property is an owner-occupied home improvement store, typical of the trend away from leased stores." (Plaintiff's Exhibit 5, p. A-27.) Yet, in spite of this comment, Leary proceeds to review other stores located in Connecticut that were leased to Home Depot – in North Haven, Berlin, Orange and Bridgeport – to establish market rent for the subject. Using these four stores, Leary was of the opinion that the market NNN (triple net rent) unit range for the property as of the effective date of appraisal is $11.50 to $12.00/SF of GLA (gross leased area). See id. As of October 1, 2007, Leary concluded that "[a] prudent landlord would set aside a vacancy/management/reserve allowance of 7.5% against the low end of the market rent ($96,503) to 10.0% against the high end of the market rent ($134,264) to reflect the risk inherent in the subject location as of the effective date of appraisal." (Plaintiff's Exhibit 5, p. A-28.)

The court is well aware that in spite of the subject property being owner-occupied, and therefore, non-income producing, the appraisers and the parties contend that the valuation of the subject property can be determined by the use of the income capitalization approach. For example, the defendant notes as follows:

"Although the Property's current occupant as of the valuation date was Home Depot as an owner-occupant, both appraisers agreed that the highest and best use was not as owner-occupied. This is because the Property was considered by the market as an investment property – i.e., one that was highly attractive to real estate investment trusts ('REITs') and other institutional investors for its steady and reliable income stream that could be generated by either Home Depot as tenant or by another large retail tenant. In other words, the market of potential buyers for the Property was not limited to owner-occupants, but in fact as Dondiego testified, was predominantly large income investors. That is why both appraisers conducted and placed reliance on an income approach to valuation." (Citations omitted.) (Defendant's 2/13/12 brief, p. 5.)

The court is at odds with this analysis because the subject property is not fictional. It is, in fact, owner-occupied and not income-producing, as of the revaluation date of October 1, 2007 to the present. The court recognizes that other jurisdictions have approved of the use of the income approach to value owner-occupied buildings.[2]

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As an example, the court in Norton Co. v. Watervliet, 739 N.Y.S.2d 206, 208 (3d Dept. 2002), discussed a case in which an appraiser was precluded from using the income approach for an owner-occupied property, and noted that "[a]ny fair and nondiscriminating method that will achieve that result is acceptable." (Internal quotation marks omitted.) The Norton Co. court further noted that "the petitioner's appraiser was questioned extensively on this issue

With the use of the income capitalization approach, both appraisers had to speculate on various factors including: (1) converting the subject building into a building that contained tenant(s); (2) calculating the rental income amount by selecting properties that are used primarily for the purpose of producing rental income; and (3) calculating a vacancy/collection rate when this is not applicable to an owner-occupied building. In addition, the appraisers would need to speculate on the amount of operating expenses to arrive at NOI that would be capitalized to produce a final valuation figure. Consequently, the speculation results in a wide divergence between the appraisers' opinions of value for the subject using the same income approach to value.

Responding to a question on cross-examination, Dondiego testified that under the concept of the income approach to value the subject property, Home Depot would need to sell the subject property and then lease it back. According to Leary, there would be no motivation to sell and lease back the subject property because Home Depot was trending

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and unequivocally testified that, although the property was owner-occupied and not income-producing in the sense that no rental activity was present, it was nevertheless acceptable to utilize the income approach based on existing market data to determine its value." Id.

On this same issue, in Great Adventure, Inc. v. Jackson Township, 10 N.J. Tax 230, 232 (App. Div. 1988), the court noted that "the phrase 'income-producing property' must be construed as a term of art in accordance with the understanding commonly ascribed to it by the business, investment, and real estate community. . . . [and] is generally limited to property producing rental income."

While both appraisers concluded that the highest and best use of the subject was its current use as a home improvement store, it is nevertheless an existing fact that the subject is owner-occupied and not income-producing for nearly twenty years, from the date of its construction to the present.

back from leasing to owner-occupying. According to Dondiego, if he had concluded that the highest and best use of the subject was owner-occupied, he would not have used the income approach.

There is a further example of the difference between Leary and Dondiego in the use of the income approach: Leary opined that the market rent for the subject, if it were income-producing property, would be $11.50/SF to $12/SF (see plaintiff's Exhibit 5, p. A-27); Dondiego opined that the market rent for the subject, if it were income-producing property, would be $15/SF (see defendant's Exhibit A, p. 27). The treatment of the subject property, as if it were income-producing property, is in conflict with General Statutes § 12-63b (b) which provides as follows: "For purposes of subdivision (2) of subsection (a) of this section and, generally, in its use as a factor in any appraisal with respect to real property used primarily for the purpose of producing rental income, the term 'market rent' means the rental income that such property would most probably command on the open market as indicated by present rentals being paid for comparable space. *In determining market rent the assessor shall consider the actual rental income applicable with respect to such real property under the terms of an existing contract of lease at the time of such determination."* (Emphasis added.) See also Sheridan v. Killingly, 278 Conn. 252, 262-63, 897 A.2d 90 (2006).

In establishing market rent, neither Leary nor Dondiego relied on Home Depot's purchase of its 100,744-SF Fairfield store on 9.19 acres that sold in April 2003 for $22,820,000. As reported by Leary, Home Depot was paying rent of $18.31/SF at the time of this sale. See plaintiff's Exhibit 5, p. A-30.

The defendant makes a cogent but unsupportable argument for the use of the income approach:

"Both experts agreed that the Property's highest and best use ('HABU') as improved was its continued use as a large big-box retail home improvements store. As Dondiego testified, the market for this property type is not limited to owner-users, but is predominantly REITs and other large institutional investors. The experts also agreed that, because the market includes such investors, the fact that the current occupant as of the valuation date happened to be an owner-user did not affect their HABU conclusion. The Korpacz Third Quarter 2007 survey confirms that national retail power centers like the subject were highly attractive to investors seeking reliable income yields, either by leasing back to a seller-occupant or leasing to another power-center store. Because the market to purchase such properties was strong as of the valuation date, it is not surprising that both appraisers also agreed that the Property is not a special purpose property. In short, the market considered the Property as well as other national retail power centers, as attractive investment properties as of the Valuation Date, dictating the use of an income approach as a valid indicator of value." (Citations omitted.) (Defendant's 2/13/12 brief, pp. 24-25.)

The premise that the subject property was ripe for purchase by large institutional investors cannot be sustained in view of the known facts that the subject was purchased by Home Depot for its own use and Home Depot continued in this status as owner-occupant to the present time. There is no indication from the facts, as presented, that Home Depot, on October 1, 2007, would consider selling the subject property or converting it to an income-producing property.

Home Depot's purchase of the Fairfield store in April 2003 for $22,820,000, in which it changed from a tenant to an owner-occupant, confirms Leary's previous comment (noted above) that Home Depot was following the trend, moving from its leasing stores to owner-occupying stores. In 1989, Home Depot had leased the Fairfield property on a build-to-suit basis. It exercised a provision in its lease to purchase the property when the rental rate had grown to $1,845,000 or $18.31/SF of GLA and the owner indicated a desire to divest itself of the property. See plaintiff's Exhibit 5, p. A-30.

Dondiego's use of a sale of a Lowe's Home Center (Lowe's) in Syracuse, New York is another example of a large retailer purchasing rather than leasing. Dondiego reported that Lowe's was motivated to buy the property rather than lease it because ownership was more economical.

In this case, it is not credible to use the income approach to value property that is not income-producing.[3] First, the highest and best use of the subject would have to be changed from its current use, as concluded by both Leary and Dondiego, to that of an income-producing property, which in effect, Leary and Dondiego have done in selecting the use of the income approach as their prime approach.[4] Second, in order to justify using

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"Income-producing real estate is typically purchased as an investment, and from an investor's point of view, earning power is the critical element affecting property value. . . . An investor who purchases income-producing real estate is essentially trading present dollars for the expectation of receiving future dollars. The income capitalization approach to value consists of methods, techniques, and mathematical procedures that an appraiser uses to analyze a property's capacity to generate benefits (i.e., usually the monetary benefits of income and reversion) and convert these benefits into an indication of present value." The Appraisal of Real Estate (12th Ed. 2001) p. 471.

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The defendant contends that both Leary and Dondiego agreed that the highest and best use of the subject was not "owner-occupied." See defendant's 2/13/12 brief, p. 28. Dondiego testified that he did not appraise the subject property as owner-occupied, but as an investment property. This statement is contrary to the court's conclusion that the highest and best use of the subject property was, as of October 1, 2007, an owner-occupied home improvement store.

The defendant, in arguing that § 12-63b does not rule out the use of the income approach, makes the following comment: "To interpret § 12-63b to preclude an income approach just because a property has no tenant as of the valuation date would rule out an income approach for a multi-tenant office building that happens to be vacant - surely the legislature did not intend such an unworkable result. See also The Appraisal of Real Estate, pp. 480, 500 (appropriate to use income approach for owner-occupied properties by estimating market rent)." (Defendant's 2/13/12 brief, p. 28.)

First, to rule out the use of the income approach for a vacant multi-tenant office building is inconsistent with the defendant's argument. A multi-tenant office building, even if vacant, has no other highest and best use other than to rent the vacant space and produce rental income.

Second, the defendant's reference to The Appraisal of Real Estate, pp. 480, 500, the income approach, as applied to the subject, both appraisers had to deal with a fictional property that produced a certain amount of income based upon what the market rent would be if the subject were in fact income-producing property. The appraisers also had to speculate what the operating expenses would be, as well as determine what the vacancy/collection loss would be even though the subject, being the only fictional tenant on the premises, would probably not have a collection loss. In addition, the capitalization rate selected by Dondiego was based on three sales, two of which were BJ's Wholesale Club (BJ's) stores in Fort Lauderdale and Miami, Florida. Dondiego developed a market cap rate for the Fort Lauderdale sale at 6.96% and 5.67%[5] for the Miami sale. Dondiego's third sale was the Lowe's in Syracuse, New York from which he developed the cap rate of 6.67%.

In the use of the income approach, Dondiego arrived at a market rent of $15/SF. This amount was arrived at by surveying "recent leases negotiated in competitive

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apparently comes from the statement on p. 480 that "[r]ent for vacant or owner-occupied space is usually estimated at market rent levels . . . ." In proper context, this statement could refer to an income-producing property that contains vacant space and owner-occupied space. See, e.g., In re Mutual of America Life Ins. Co. v. Tax Commission, 892 N.Y.S.2d 327 (App. Div. 2009), in which an insurance company was the owner of a 34-story commercial office building in which it owner-occupied 40% of the 675,000 SF as its corporate headquarters. During the first tax year, 30% of the remaining rentable office space remained vacant.

As to the reference to p. 500, the reference to owner-occupied appears in context to the interests in the property being appraised.

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See defendant's 2/13/12 brief, p. 33, n.22.

buildings in the marketplace. . . . The comparable leases have terms ranging from 15 to 20 years. The comparables exhibit a range of rents from $10.79 to $21.63/SF, with an average of $16.56/SF." (Defendant's Exhibit A, p. 27.) Other than size, with the subject Home Depot building covering 111,887 SF of GBA, there is nothing else comparable about the subject Home Depot building with the so-called comparable leases that Dondiego refers to.

Discounting the use of the income approach and the cost approach, the only reliable approach to value that has credibility is the sales approach. Since only Dondiego analyzed the valuation of the subject pursuant to the sales comparison approach, the court's analysis will be focused on this course. Dondiego and Leary considered the subject Home Depot property to be a national retail power center. As a result, Dondiego looked to retail national power centers outside of Connecticut such as those in Fort Lauderdale, Miami and Syracuse.

Sale one was a sale of a BJ's store built in 2007 and containing 124,015 SF of GBA. BJ's entered into a 20-year lease of the store in early 2008. In September 2008, the store was sold to Cole BJ Ft. Lauderdale FL, LLC for the sale price of $28,272,857 or $227.98/SF. See defendant's Exhibit A, p. 21 and addendum p. 1.

Sale two was a sale of a BJ's store located in Miami, Florida with 114,209 SF of GBA in September 2006 shortly after BJ's signed a 20-year lease in the same year. The sale was to the Cole Companies, an investor group, for $25,757,400 or $225.53/SF. See defendant's Exhibit A, p. 21 and addendum p. 2.

Sale three was a sale of a Lowe's store containing 137,569 SF and located in Syracuse, New York. The building was constructed in 2007 for Lowe's as a tenant. Lowe's bought out its lease in February 2009 for the purchase price of $27,000,000 or $196.27/SF. See defendant's Exhibit A, p. 21 and addendum p. 3.

In addition to the above three sales, both appraisers recognized that Home Depot's purchase of the Fairfield store in April 2003 for $22,820,000 was comparable to the subject. However, Leary contended that Home Depot paid a premium to purchase this store. As noted previously, Home Depot's rental rate of $18.31/SF in 2003 was substantially higher than the rents used by the comparables selected by Dondiego. This gives credence to the fact that the Home Depot store in Fairfield was located in a more affluent area than Danbury, allowing for a higher purchase price than the subject property in Danbury.

There is a common thread that appears to establish a market for the sale of retail power centers when considering Lowe's, BJ's and Home Depot stores. This thread comes into play from the construction of a free-standing retail power center building, the use of a long-term lease to a retail power center and a subsequent purchase of the land and building by the same retail power center within a short period of time following the execution of the lease. The BJ's store built in Fort Lauderdale in 2007 was sold in 2008. The BJ's store in Miami was built in 2006 and sold later that year. The Lowe's store in Syracuse was built in 2007 and sold in 2009. These transactions show a pattern of operation for retail power centers: building a store, entering into a long-term lease and then outright purchasing the property in short order to become an owner-occupant.

It should be noted that "the process of estimating the value of property for taxation is, at best, one of approximation and judgment, and there is a margin for a difference of opinion. . . . " (Internal quotation marks omitted.) MacLean v. Darien, 43 Conn. App. 169, 173, 682 A.2d 1064 (1996).

It is also recognized that "a tax court proceeding is not high-low arbitration where the decision maker must choose the figure submitted by one or the other party. The Tax Court brings its own expertise and judgment to the hearing, and its valuation need not be the same as that of any particular expert as long as it is within permissible limits and has meaningful and adequate evidentiary support." Carson Pirie Scott & Co. (Ridgedale) v. Cnty. of Hennepin, 576 N.W.2d 445, 451 (Minn. 1998).

Upon review of Dondiego's comparable sales, especially the fact that the 14-year-old subject was substantially older than the comparables used by Dondiego, and after consideration of the analysis provided to the court by both parties, the court finds that the fair market value of the subject property, as of October 1, 2007, is much closer to the value calculated by the defendant's appraiser Dondiego. Giving due consideration to all of the evidence presented in this case, including the sale of the Home Depot store in Fairfield, which appears substantially overvalued, it is the firm conviction of the court that the fair market value of the subject, as of October 1, 2007, is in the range of $180/SF.[6] Applying this amount to the subject's GBA of 111,887 SF, results in a fair market value of $20,139,660 for the revaluation date of October 1, 2007 and subsequent years.

Accordingly, judgment may enter in favor of the plaintiff, sustaining its appeal, without costs to any party.

Arnold W. Aronson
Judge Trial Referee

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The range of dollars per GBA runs from Leary's use of the cost approach between $121.55/SF to $123.34/SF and Dondiego's use of the sales approach resulting in a GBA value between $196.27/SF and $227.98/SF. The range between Leary's $14,000,000 value and Dondiego's $21,800,000 value results in a GBA value between $125/SF and $195/SF.