NO. CV 09 4010182S	:	SUPERIOR COURT
RIVER PROPERTIES INC.	:	JUDICIAL DISTRICT OF
	:	MIDDLESEX
	:	AT MIDDLETOWN
v.		
TOWN OF ESSEX, ET AL.	:	FEBRUARY 22, 2010

MEMORANDUM OF DECISION

This action is a real estate tax appeal in which the plaintiff, River Properties, Inc., challenges the valuation placed upon its marina, known as Dauntless Shipyard, located at 37 Pratt Street, in the town of Essex (town), on the Grand List of October 1, 2008.

As of October 1, 2008, the following valuations were calculated for the subject marina:

$4,143,400 by the town's assessor;

$3,115,000 by the plaintiff's appraiser, Thomas Merola; and

$4,500,000 by the town's appraiser, James B. Blair.

The subject premises is an active marina located along the west bank of the Connecticut River in Essex. It has both a waterside component and a landside component containing 5.27 acres of land.

The waterside component contains a travel lift slip, fixed piers and floating docks providing for a total of 105 boat slips, plus additional dock space for service and various other boatyard activities. In addition, there are five moorings in the Connecticut River that are used for boat servicing. This component has wood bulkheading and stone/concrete retaining walls along 1,500 feet of the Connecticut River's banks. Individual slips are serviced by fresh water, cable and electricity. The waterside component requires ongoing improvements to bulkheads, piers, dock replacements and dredging. In addition, over the past eight to ten years, the land has been sinking because the lower portion of the property is on a peet bog. This condition requires that the travel lift area be repaved and that additional gravel is brought in to maintain the yard levels.

The landside component is located on the east by the Connecticut River; on the south by Pratt Street; and on the north and northwest by single-family residences located along Bushnell Street. This component is serviced by electricity, telephone, cable and public water. Sewerage is provided by on-site septic systems. The subject lies in a waterfront business district (WF) zone which requires that 70% of the office space on the subject property be marina-related. Up to 30% of the subject's office space may be used for non-related marina business. The warehouse on the subject must have a use that is marina-related.

The landside component contains six separate buildings with a total square footage for all the buildings at 48,490 square feet:

1) a two-story, 14,000-square-foot office building;

2) a 13,720-square-foot metal building used for the storage and repair of boats;

3) a two-story office building containing 3,295 square feet housing the marina office, a small deli and a recreational pool for boat owners;

4) a two-story, row-style wood frame structure containing 4,788 square feet of space leased to commercial marine users, namely, New England Yacht Services, National Marine Distributors Association, Boat Work Yacht Sales and Barlow Yacht Associates;

5) a one and a half story building of 1,470 square feet used by a yacht brokerage firm; and

6) a 9,764-square-foot building under construction to be used for boat storage which includes a finished second floor space of 1,453 square feet.

Both appraisers, Merola and Blair, concluded that the highest and best use of the subject is its ongoing use as a marina. Both appraisers also concluded that the cost approach could not be used in the valuation of the subject because it would be difficult to estimate the accrued depreciation of the improvements to the property. However, both appraisers considered the income approach and the sales approach as an appropriate method to determine the fair market value of the subject as of October 1, 2008.

Considering the income approach for the subject property, Merola was careful to differentiate between those sources of income and expenses related to the real estate portion of the operation versus the operation of the boatyard as a going-business concern. As Merola noted: “While it is likely that boatyard activities such as sales, service and repairs may represent a substantial source of revenue, the purpose of this analysis is a valuation of the real estate component of the subject property. In this analysis we have estimated the value of the subject property via the Income Approach giving consideration only to revenue and expenses which are specifically allocable to the real estate component of the property. We were able to obtain enough dockage rent and yard rental information from similar properties as well as extract sufficient data from the current leases in order to determine a value via the Income Approach." (Plaintiff's Exhibit 3, p. 22.)

Merola's analysis of the income attributed to the waterside component of the subject property comes from a survey of slip rentals from marina facilities from Clinton to Essex, noting that the range of slip prices at full service marinas runs from $100-$150/linear foot (lf) of boat. See plaintiff's Exhibit 3, p. 26. For 105 slip rentals at the subject, Merola estimated waterside income from slip rentals at $446,250 based on an average boat length of 34 feet at $125/lf. With a 5% vacancy and credit loss deducted from the gross income of the waterside component, Merola arrived at an effective gross income of $423,938 for slip rentals. Within the waterside income, however, Merola included $39,800 for environmental reimbursement and $23,750 for transient rental income, to arrive at an effective gross income of $487,488 for the waterside component. See plaintiff's Exhibit 3, p. 32.

The town's appraiser, Blair, using the rental income information provided by the subject's owner, arrived at a slip rental income of $470,000. This amount fairly reflects the slip rental income developed by Merola since Blair did not take into consideration the additional income from environmental reimbursement and transient rental income and Merola did not consider reducing the rental income by 5% that Blair deducted to reflect what he considered to be "softer market conditions." (Defendant's Exhibit A, p. 50.)

On the landside component, Merola calculated the potential gross income for the marina's buildings at $458,195, less a 10% vacancy & credit loss allowance to arrive at an effective gross income of $412,376. To this amount Merola added $489,280 for winter storage income, that included a vacancy & credit loss allowance, to arrive at an effective gross income for the landside component of the boatyard operations at $901,656. See plaintiff's Exhibit 3, p. 32.

Merola's and Blair's calculations have similarities on some income items on the landside component: Merola's winter storage income is at $489,280 while Blair's is at $490,000. The difference between Merola and Blair for the balance of the landside income comes from Blair using the actual office and retail rental figures from the plaintiff's 2008 income tax records as market figures. Merola developed his income for the balance of the landside component by using $6.95/square foot on a modified gross basis for industrial/warehouse/shop property and $15/square foot as market rent for the commercial and office space with the tenant responsible for heat and electricity and the landlord responsible for real estate taxes, insurance and building maintenance. See plaintiff's Exhibit 3, p. 28.

It is interesting to note that Merola and Blair are essentially in agreement that the plaintiff's 2008 income and expense tax figures represent the market. The only difference between the two is Blair's development of income from the plaintiff's landside operation of the marina by relying on the figures reported on the plaintiff's 2008 income tax return.

Based on his analysis of the income produced by the subject marina from the waterside and the landside components, Merola arrived at an effective gross income of $1,389,143 on the revaluation date of October 1, 2008. Merola's determination of the effective gross income of the subject at $1,389,143 is accepted by the town. See defendant's post-trial brief, dated December 21, 2009, p. 7 ("[t]he defendant Town accepts this figure [$1,389,143] as being accurate since it is based upon income figures for the calendar year ending December 31, 2008 as shown on plaintiff's Exhibit 2").

Turning to the expense side of the valuation analysis, there is a wide divergence between Blair's opinion regarding expenses totaling $731,250 and Merola's opinion regarding expenses totaling $1,028,495. In fact, considering the landside expenses, Merola's and Blair's analyses of the expense figures were at odds. Whereas Merola estimated the landside expense figures for the office and retail rentals using the actual expense figures of the plaintiff as market-related, Blair used his own estimates based upon his experience rather than develop his expense rental figures based on a study of market conditions. In developing income and expense data, "an appraiser investigates comparable sales and rentals of competitive income-producing properties of the same type in the same market. . . ." The Appraisal of Real Estate (12th Ed. 2001) p. 501. An appraiser's estimates, based upon his or her experience, is no substitute for an objective observation of the market forces. "[A]n opinion of market value must be based on objective observation of the collective actions of the market." Id., 21.

In this case, both appraisers Merola and Blair considered the income and expenditures of the subject marina to represent market conditions. Although the parties are in agreement regarding the effective gross income, when it comes to expenses, the parties' disagreement centers around salaries and labor costs. The parties are fairly close on figures for management and administration. The plaintiff set its management and administration expenses at $97,240 based upon 7% of the effective gross income of $1,389,143. On the other hand, Blair arrived at a figure of $105,000, as a lump sum for "manager" and "advertising", which amounts to 7.6% of the effective gross income of $1,389,143.

As previously discussed, the significant difference between the two arises from salaries and labor costs. Merola had officers' salaries and yard labor costs at $400,000 plus $25,000 for employee benefits, including FICA, medicare and retirement or approximately 30% of the subject's 2008 operating expenses of $1,402,924. Blair allocated $225,000 for employees and $82,500 for employee benefits totaling $307,500 or approximately 22% of the subject's 2008 operating expenses.

The subject property's operating expenses for the year ending December 31, 2008 (see plaintiff's Exhibit 2) lists salaries of $465,580, employee benefits of $90,086, pension expenses of $68,602 and FICA at $71,192 for a total of $695,460. This figure represents approximately 50% of the marina's total operating expenses.[1]

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[1] "The appraiser should be wary of excessive repairs and maintenance expense, unusually high payroll costs, and any personal expenses charged to the business entity. The owner's

Given the disparity that exists between Merola and Blair in arriving at total operating expenses for the subject, it is more credible to look to the plaintiff's filing of the 2007 Annual Income and Expense Report, which was required to be filed with the assessor on or before June 2, 2008. See defendant's Exhibit B.

The list of operating expenses shown in defendant's Exhibit B contains items that are unrelated to the valuation of real estate. See, e.g., The Appraisal of Real Estate (12th Ed. 2001) p. 521. These items include depreciation of $121,502; real estate/personal property taxes of $38,185 and bank charges of $7,682, for a total of $167,369. These three items reduce the operating expenses of the subject from $1,141,122 to $973,753.

Since the parties basically agree that the effective gross income of the subject for October 1, 2008 was $1,389,143, the next step in the income approach is to deduct the resulting total operating expenses of $973,753 to arrive at a net operating income of $415,390. The value of the real estate is derived by using the direct capitalization method, a method used by both Merola and Blair, dividing the net operating income by a capitalization rate.[2]

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operating statements are likely to be set up as determined for income tax purposes. This is always net income after depreciation, interest expense, and income taxes. On the other hand, net income for purposes of capitalization is calculated *before* such deductions. It is, therefore, advisable to present the owner's statement of income and expenses as furnished and then adjust the net income figure to exclude these charges." Nicholas S. Haddad, *Appraisal of Marinas*, Encyclopedia of Real Estate Appraising (3rd ed. 1978) p. 883.

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"Direct capitalization is a method used in the income capitalization approach, to convert a single year's income expectancy into a value indication. This conversion is accomplished in one step . . . by dividing the income estimate by an appropriate income [capitalization] rate."

The disparity in the development of the capitalization rate between Merola and Blair, for the most part, comes from Merola using the equity portion of the rate at 30% compared to Blair's use at 25% and from Merola using the loan-to-value at 70% compared to Blair's use of the loan-to-value at 75%. Both appraisers added an effective tax rate of 0.01187 to their capitalization rate. Merola arrived at a final capitalization rate of 11.5% compared to Blair's determination of a final capitalization rate of 10.2%. Giving consideration to the input from both appraisers, a capitalization rate of 11% (which includes an effective tax rate) appears to be a credible resolution in this case.[3] Given a net operating income of $415,390 as found by the court, divided by a capitalization rate of 11%, results in a fair market value of $3,776,273 for the subject property as of October 1, 2008.

Turning to the remaining sales approach to value used by both appraisers, the problem with the valuation of the subject property, using the sales approach method, is that it consists of more than just a marina, namely, commercial buildings and a warehouse. As Blair describes his valuation of the subject, using the sale approach, the valuation is broken down into three components: 105 slips at $25,000/slip or $2,625,000; office buildings totaling 21,758 square feet at $60/square foot or $1,305,480 and a 15,000 square foot warehouse at $36/square foot or $540,000, for a total value of the subject at

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The Appraisal of Real Estate (12th Ed. 2001) p. 529.

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Blair arrived at a capitalization rate of 9% plus taxes. Merola arrived at a capitalization rate of 10.32% plus taxes.

$4,470,480 rounded to $4,500,000. Significantly, the non-marina portion of the subject is approximately 70% of the marina valuation. Interestingly, Blair sought out separate comparables for marinas, office space and warehouse space, rather than sales containing all three components.

Considering the uses of the subject property as a marina, office and warehouse, as described by Blair, Merola makes the following point: "The diversity of the individual comparable sale facilities makes comparison difficult. In addition, in many instances there are unusual circumstances surrounding sales of marina and boatyard properties, and seldom are the sales of the various marina properties straightforward transactions (sales often have involved operators exercising lease purchase options or have included boatyard equipment such as travel lifts and boat stands as well as going concern considerations). Our research indicates that marina properties are often family-oriented businesses which were purchased by individuals who intended to operate the facilities." (Plaintiff's Exhibit 3, p. 38.)

Merola, recognizing the combination of components to the subject property, found it difficult to make a reliable adjustment, and therefore, considered the sales approach to be substantially less reliable. Compared to Blair's valuation using the sales approach, Merola calculated a strikingly different valuation at $3,115,000. The difference between the two appraisers points out the use of the sales approach as an unreliable method to value the subject property because of the difficulty in obtaining comparable sales that relate to the subject property.

In summary, the income approach is the only credible method to use in this case to arrive at a fair market value of the subject. Accordingly, the fair market value of the subject property, as of October 1, 2008, is $3,776,273. Judgment may therefore enter in favor of the plaintiff, sustaining its appeal, without costs to either party.

Arnold W. Aronson
Judge Trial Referee