

Property Valuation Topics Winter 2009

Walgreen's Build-to-Suit Business Model Valued

To suit its business needs, Walgreen Company contracts with developers around the country to produce its stores. Because the lease payments on a very long-term, triple-net basis are designed to compensate the developers for all pre-development activities, as well as for creating stores with such features as drive-through windows, specially-designed fiber optics systems and high ceilings, rents are in excess of market rate for comparable retail space.

Walgreen challenged the *ad valorem* tax assessment of two properties in Madison, Wisconsin. After being rejected at trial and in the intermediate appellate court, the Wisconsin Supreme Court reversed in a resoundingly positive decision.

While the ruling rested in significant part on Wisconsin law and the Wisconsin Property Assessment Manual promulgated by that state's Bureau of Assessment Practices, a critical idea was endorsed by the Wisconsin Supreme Court. The Court held that one may not value real estate on the basis of inflated rent payments; a lease never increases the market value of the *fee simple* estate.

The court ruled that it is the market rental rate which undergirds the income valuation approach. Under Wisconsin law, income valuations must be based on market rental rates rather than contract rates "with an exception in cases in which (existing leases) lower the property value below market rate."

This "exception" is a bit troubling because it would appear to give property owners the best of both possible worlds, i.e., property assessments do not increase to reflect *above* market rents but must be lowered to reflect *below* market rents. Absent this distinction, the Wisconsin ruling should have wide application.

Walgreen Co., v. City of Madison (July 8, 2008).

Elliott B. Pollack at (860) 424-4340 or at ebpollack@pullcom.com can reply to questions about this decision.

Property "Tax Cap" Discussed

Governor Rell's suggestion that Connecticut adopt a three percent property tax cap was reintroduced at the General Assembly last session. In *The Connecticut Economy* (Spring 2008), the quarterly economic review of the University of Connecticut, Steven P. Lanza reviews the merits of this proposal. Mr. Lanza notes that Connecticut ranks unpleasantly high in all measures of property tax relativity. Property taxes take 5.2 percent of our citizens' income annually, the fourth highest in the nation; we are second in the country in property taxes measured on a *per capita* basis. Connecticut ranks tenth in the amount of property taxes it raises as a percentage of home values.

Nevertheless, Mr. Lanza's research indicates that "there is little evidence that tax caps do much to constrain property taxes, all things considered." He cites the unsatisfactory experience of 29 states to support his position.

He also comments on the inevitable relationship between quality of services and taxes. Because Connecticut demands high quality education, more money is necessary. "Keeping pupil-teacher ratios low, for instance," he observes, "may be one way to provide for a more enriching classroom experience, but doing that takes money."

Mr. Lanza argues that Connecticut should allow its municipalities to "experiment with other tax mechanisms" such as sales or income taxes, which would require General Assembly approval.

He seems to be on quite firm ground in noting that property tax caps "promote suburban and exurban

sprawl.” The demand for services pushes towns to increase the size of their taxable bases. Mr. Lanza theorizes that tax caps that hold property tax rates down “would likely aggravate the problem, and lead to more strip malls and big box stores in the countryside.”

There would appear to be no easy answers here.

Facade Renovations Produce Higher Rents

A whole generation of glass-clad office buildings will need retrofits in the next ten years,” The New York Times reported on September 3, 2008.

Not only can facade renovations improve buildings’ aesthetics; they may also improve energy efficiency. Replacing 40 and 50-year old fenestration in buildings well-located in urban central business districts can also increase square footage “by moving the window line farther from the core” of the building.

Some of these buildings are also applying for environmental LEED certification which will enhance their attractiveness to an increasingly green oriented tenant base.

Whether these improvements will drive NOI increases, especially under current economic conditions, remains to be seen. If they do, owners must be concerned about potential ad valorem assessment increases, too.

For further information, please contact Laura A. Bellotti at (860) 424-4309 or at lbellotti@pullcom.com.

Mischief from Green Buildings Legislation?

Connecticut Public Act No. 07 242 is an important piece of environmental legislation requiring new standards of “greenness” in state operations and buildings. However, buried within this law is a requirement that could substantially reduce the value of larger buildings undergoing partial renovations.

Commencing after January 1, 2010, renovations must comply with leadership and energy and environmental design (LEED) standards unless an exemption can be obtained. The exemption is available if “the cost of such compliance significantly outweighs the benefits.”

To the extent that significant LEED renovation compliance costs are entailed, building owners may be required to contend with assessors who will seek to increase building assessments to reflect high renovation costs – not the value added by the renovations.

For further information, please contact Brad N. Mondschein at (860) 424-4319 or at bmondschein@pullcom.com.

Attorney Notes

Pullman & Comley Property Valuation Department Chair **Elliott B. Pollack** will present at an upcoming seminar of The Association of Corporate Counsel, Westchester/S.CT Chapter on March 18, 2009. He will speak on property tax appeals in Connecticut and New York.

Gregory F. Servodidio and **Laura A. Bellotti**, members of the Property Valuation Department, presented a teleseminar on “Property Tax Exemptions and Abatements: Successful Negotiation Strategies” on November 25, 2008, for Strafford Publications.

PULLMAN & COMLEY, LLC ATTORNEYS AT LAW

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850 Main Street Bridgeport, CT 06604 Phone: (203) 330-2000 Fax: (203) 576-8888	90 State House Square Hartford, CT 06103 Phone: (860) 424-4300 Fax: (860) 424-4370	107 Elm Street, 4th Floor Stamford, CT 06902 Phone: (203) 324-5000 Fax: (203) 363-8659	253 Post Road West Westport, CT 06880 Phone: (203) 254-5000 Fax: (203) 254-5070	50 Main Street White Plains, NY 10606 Phone: (914) 682-6895 Fax: (914) 682-6894
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Winter 2009
Volume XII / Issue 1

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Assemblage Valuation Ruling Sustained

In a recent issue of *PVT*, we wrote about the effort of John Allen Sakon to obtain significant assessment reductions of three separate, contiguous parcels of undeveloped land owned or leased by him in Glastonbury.

The Glastonbury assessor valued the parcels at more than \$122,000 per acre. In a relatively unusual development, the Board of Assessment Appeals reduced the valuations to about \$40,000 per acre. At trial, Mr. Sakon asserted that his real estate should be valued at a tiny fraction of the reduced value.

In supporting the town's valuation, the trial court relied on "the doctrine of assemblage to combine the three parcels for purposes of valuation and then determined the highest and best use of the assembled property" for commercial use. Superior Court Judge Trial Referee Arnold W. Aronson's decision on this point was sustained by the Connecticut Appellate Court which rejected Mr. Sakon's position that it was "not appropriate to value parcels as an assemblage when the parcels appear separately on the Grand List."

As long as there is a reasonable probability that the owner can use the parcels together and that "a prospective, integrated use" can be shown to be the highest and best use of the parcels, the assemblage doctrine is acceptable; however, it should not be used casually or speculatively, the Court ruled.

Interestingly, Mr. Sakon argued that the only "plausible use" of his parcels was as a park and that a special permit from Glastonbury zoning authorities was necessary to develop the properties. Ironically, however, having applied to develop all three parcels together as an assemblage for

commercial purposes, he was hard pressed to argue that commercial development was not feasible under any reasonable circumstances.

Sakon v. Town of Glastonbury, Appellate Court of Connecticut, 111 Conn. App. 242 (2008).

For further information about this important litigation, please contact Gregory F. Servodidio at (860) 424-4332 or at gservodidio@pullcom.com.

Wall Street and Connecticut Residential Values

If it was necessary to underscore the relationship between regional and national economic markets, another reminder was received in the *Commercial Record Daily* of November 24, 2008. According to *CRD*, "the outlook for southwestern Connecticut's housing market has taken a turn for the worse as a result of the fallout from massive job losses in New York area financial firms."

The *CRD* notes that housing prices in Connecticut's Fairfield County "gold coast" area are expected to decline 12 percent in 2009 – "much faster than the 7 percent decline experienced over the 12 month period that ended June 30, 2008."

PVT editors hope that this forecast is not accurate and that there will be less pain in southwestern Connecticut than is currently anticipated.

