

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF ORANGE



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In the Matter of the Application of:  
VGR ASSOCIATES, LLC & PRICE CHOPPER  
OPERATING CO., INC.,

Petitioners,

**-against-**

Index No: 2002/5074  
2003/4750

THE ASSESSOR, THE BOARD OF ASSESSMENT  
REVIEW OF THE TOWN OF NEW WINDSOR AND  
THE TOWN OF NEW WINDSOR,

**DECISION AND ORDER**

Respondents.

For Review of a Tax Assessment Under  
Article 7 of the Real Property Tax Law.

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**PRICE CHOPPER PLAZA : VALUATION OF A SHOPPING CENTER**

In this latest examination of shopping centers<sup>1</sup> this Court must determine the true market value of a shopping center<sup>2</sup>, the Price Chopper Plaza located in the Town of New Windsor, New York [ " subject property " ]. This tax certiorari proceeding was commenced by the Petitioner, VGR Associates, LLC [ " VGR " ] and Price Chopper Operating Co., Inc. [ " Price Chopper " ] to review the 2002 and 2003 tax assessments imposed by the Town of New Windsor, New York [ " the

Town " ] on the subject property. Following a trial which took place on January 30 & 31, 2006 and April 14, 2006 and after a careful review of the excellent Memoranda of Law<sup>3</sup> and findings of fact and conclusions of law<sup>4</sup> submitted by the parties, the Court is now prepared to render its Decision on the true value of the Price Chopper Plaza.

### FACTUAL BACKGROUND

#### Price Chopper Plaza

The subject property is a 121,000 square foot, 11 acre shopping center located in the " Five Corners " area of the Town of New Windsor, New York. It is identified on the Town's Tax Map as ID #69-1-6 and is situated at the corner of Route 32 and State Route 300. The subject property was built in 1969 and renovated in 1995. For the tax years under review, the subject property included a 61,500 square foot Price Chopper Supermarket as an anchor, a 15,200 square foot Eckerd store as a secondary anchor, along with 11 satellite stores totaling 41,049 square feet, averaging 3,730 square feet per store<sup>5</sup>. An HSBC Bank which is still operating under the original 1969 lease sits on a separate pad. In 2000, a 7,000 square foot store was built adjoining the Price Chopper Supermarket and is currently occupied by Advanced Auto<sup>6</sup>.

### Golub, VGR, Vails Gate & Price Chopper

When originally built in 1969, the subject property was occupied by a Grand Union Supermarket. Subsequently, Waldbaums occupied the supermarket space and expanded the Grand Union space. On or about March 15, 1995, Golub Corporation [ " Golub " ] paid \$3.1 million for the Waldbaums leasehold interest<sup>7</sup>. On September 30, 1995, VGR Associates [ " VGR " ], as fee owner, entered into a ground lease with Vails Gate, LLC<sup>8</sup> [ " Vails Gate " ]. Vails Gate simultaneously entered into a twenty-five year sublease with Price Chopper which lease is guaranteed by its parent corporation, Golub<sup>9</sup>.

### The Sublease & Tenant Improvements

The Price Chopper sublease to Vails Gate simultaneously reimbursed Golub the \$3.1 million for its original purchase of the Waldbaum's lease and provided in the lease that the \$3.1 million was to be used by Price Chopper for "tenant improvements "<sup>10</sup>. On October 1, 1995, Golub terminated its Waldbaums leasehold interest.

### What Tenant Improvements?

A single change order document<sup>11</sup> by a contractor, Storm King, references a sum of \$2,797,436.40 [ " the change order " ]. Other than

the change order, no additional information is provided identifying what monies were actually spent on tenant improvements.

**The Mutual of Omaha Mortgage**

In 1995, Vails Gate obtained a \$4.4 million mortgage from Mutual of Omaha for twenty years which was guaranteed by the Price Chopper sublease which was guaranteed by Golub<sup>12</sup>.

**Stipulations**

The parties stipulated that the applicable equalization rates, assessed valuations, tax rates and equalized fair market values [ " FMV " ] for the tax years at issue are as follows<sup>13</sup>:

<b><u>Tax Years</u></b>	<b><u>Equ. Rates</u></b>	<b><u>Assessed Values</u></b>	<b><u>Tax Rates<sup>14</sup></u></b>	<b><u>Equ. FMV</u></b>
2002	21.66%	\$2,167,600	130.91	\$9,915,000
2003	19.21%	\$2,167,600	145.37	\$11,180,000

The parties also stipulated and agreed that Petitioners' appraiser, William R. Beckmann, MAI, CRE, and Respondents' appraiser, Barry M. Herbold, ASA, are qualified to testify in the trial and that the cost approach is not a relevant means of arriving at a fair market value for the subject property.

### The Valuation Ceiling

We have found it useful in determining the true value of income producing properties to establish a valuation ceiling above which this Court may not go<sup>15</sup> based upon certain well accepted principals. One of those principals is that the Respondents may not rely upon an appraised value [ \$12,800,000 for 2002 and \$13,100,000 for 2003<sup>16</sup> ] which exceeds the equalized full market value [ \$9,915,000 for 2002 and \$11,180,000 for 2003 ] which they established for the subject property.

### The Presumption Of Validity

In a tax certiorari proceeding, the property valuation by the Assessor is presumptively valid [ See e.g., People ex rel Wallington Apt. v. Miller, 288 N.Y. 31, 33, 41 N.E.2d 445 (1942); FMC Corp. v. Unmack, 92 N.Y.2d 179, 677 N.Y.S.2d 269 (1998), Reckson Operating Partnership L.P. v. Town of Greenburgh, 2 Misc. 3d 1005, 784 N.Y.S.2d 923 ( West. Sup. 2004 ); Johnson v. Kelly, 11 Misc. 3d 1081 ( Orange Sup. 2006 ) ]. However, this presumption disappears where a Petitioner challenging the assessment comes forward with substantial evidence to the contrary [ See e.g., FMC Corp., supra, at 92 N.Y.2d 187 ]. Clearly, a " petitioner need merely provide credible and competent evidence, usually in the form of a competent appraisal, that a valid dispute

exists concerning the property's valuations " [ FMC Corp, supra, at 92 N.Y.2d 191 ]. The standard may be satisfied by submitting a " detailed competent appraisal based on standard, accepted appraisal techniques and prepared by a qualified appraiser " [ Matter of Niagara Mohawk Power Corp. v. Assessor of the Town of Geddes, 92 N.Y.2d 192, 196, 677 N.Y.S.2d 275 (1998)].

### **Threshold Burden Met**

The Petitioners have met this threshold by introducing an acknowledged expert appraiser, Mr. Beckmann, who submitted a comprehensive appraisal<sup>17</sup> utilizing the capitalization of income approach that detailed the facts, figures and calculations used for adjusting his comparable rent to arrive at an economic rent<sup>18</sup>, verification in the marketplace of his expenses<sup>19</sup>, and selection of a capitalization rate. The Petitioners have successfully rebutted the presumption of validity by demonstrating the existence of a valid and credible dispute.

### **22 NYCRR 202.59(g)(2)**

" Under 22 NYCRR 202.59(g)(2), appraisal reports in tax assessment review proceedings must contain a statement of the method of appraisal relied on and the appraiser's conclusions as to the property's value,

along with facts, figures and calculations by which the conclusion was reached "[ Matter of Bialystock & Bloom v. Town of Stuyvesant, 290 A.D.2d 607, 608, 736 N.Y.S.2d 127 ( 3d Dept. 2002 )].

### **Qualitative Analysis**

Petitioners assert that Respondents' appraisal contravenes 22 NYCRR 202.59(g)(2) and must be rejected in its entirety. Petitioners contends that Mr. Herbold's appraisal analysis did not contain any facts, figures or calculations regarding his selection of economic rent<sup>20</sup>, and, further, that he used a qualitative analysis wherein the adjustments are not expressed as dollar or percentage amounts<sup>21</sup>.

### **Respondents' Appraisal In Compliance**

This Court finds that Respondents' appraisal is in compliance with 22 NYCRR 202.59(g)(2), and any deficiencies therein will go to the weight given to the appraisal, not to its admissibility.

### **Use Of the Income Approach**

Both Mr. Beckmann, and Mr. Herbold, relied, primarily, upon the Income Approach to estimate the full market value of the subject property<sup>22</sup>. It was the opinion of Mr. Beckmann that because the subject

property is income producing, the Sales Comparison Approach would not be " considered reliable in estimating the value of the properties " <sup>23</sup>. Although Mr. Herbold went through a Sales Comparison analysis in his appraisal, he ultimately concluded that " while useful as a guideline, we consider this approach as secondary to the Income Approach because it indicates the value of the leased fee, rather than the fee simple " <sup>24</sup>. Consequently, for the Respondent's estimate of fair market value, Mr. Herbold used only the figures he obtained using the Income Approach. Hence, this Court will only consider the various aspects of the Income Approach as set forth in the appraisals submitted by Petitioners and Respondents.

#### **The Gross & Triple-Net Methods**

Respondents valued the subject property under the Income Approach using two methods - the Gross method and the Triple-Net method. Since Mr. Herbold stated that " the gross method [ assessor's formula ] is preferred by the New York Courts " <sup>25</sup> his " Indicated Market Value Via the Income Approach " <sup>26</sup> reflects his conclusions from the Gross method. Hence, this Court will not discuss the Respondents' Triple-Net method.

#### **The Fair Market Values**

The parties' FMVs for the subject property are as follows:

<u>Tax Years</u>	<u>Petitioners' FMV<sup>27</sup></u>	<u>Respondents' FMV<sup>28</sup></u>
2002	\$8,300,000	\$12,800,000
2003	\$8,900,000	\$13,100,000

### Selection Of An Economic Rent

Both Mr. Beckmann and Mr. Herbold acknowledged that their assignment was to value the subject property on a fee simple basis [ See e.g., Merrick Holding v. Board of Assessors, 45 N.Y.2d 538, 543, 410 N.Y.S.2d 565 ( 1978 ) ( the court held that in order to avoid " distorted valuations " of contract rents " particularly those involving property subject to below market long-term leases " market rent is to be utilized to determine fair market value in a tax certiorari proceeding ); Senpike Mall Company v. Town of New Hartford, 136 A.D.2d 19, 23, 525 N.Y.S.2d 104 ( 4<sup>th</sup> Dept., 1988 ) ( " the income approach to valuation is based upon an estimate of the economic or market rent for the leased premises " ) ].

### Petitioners' Analysis: Market Oriented

Mr. Beckmann began his Income Approach valuation by examining the marketplace to obtain a market oriented income and expense analysis. Mr. Beckmann studied the actual rent in place on the subject property as a historical reference for his appraisal analysis<sup>29</sup>. He testified

that he selected each comparable property based on its use as of the taxable status date, stating that there is a " different market rent for different types of space " <sup>30</sup>. He determined " what the current market rent is for the type of space that's there " and developed a net operating income [ " NOI " ] "[a]fter looking at the expenses and then capitalizing that NOI into value." <sup>31</sup>

### **Respondents' Analysis: Stepped-Up Rentals**

Mr. Herbold used leases negotiated on an average of thirteen years before the taxable status dates of the subject property <sup>32</sup>. He did not adjust the actual rents negotiated the year of the lease, but instead used " stepped-up " rental amounts <sup>33</sup>. This method contradicted Mr. Herbold's own trial testimony wherein he stated that " Economic rent is determined by reviewing and analyzing comparable leases which are of a recent vintage <sup>34</sup>". "The more recent the subject leases, the more weight we're willing to give as being indicative of what that space is really worth because the rent resulted as a negotiation...between landlord and tenant <sup>35</sup>".

### **The Half-Box Theory, Landlord Allowance And Tenant Improvements**

Mr. Herbold asserted that the selection of economic rent based on leases in the marketplace " does not capture the entirety of the

property "<sup>36</sup>. Hence, he used the " half-box theory " which states that "[in] essence, the rent reflects half of the space "<sup>37</sup>. In an effort to capture " everything that is out there "<sup>38</sup>, Mr. Herbold added to his economic rent the \$3.1 million [ " landlord allowance " ] that Golub had initially paid for the Waldbaum's leasehold interest in 1995 and was ultimately reimbursed for by Vails Gate in the Price Chopper lease.

### **Contract Rents Not Enough**

It is the Respondents' view that the Petitioners are incorrect in their acceptance and reliance upon the contract rents paid by Price Chopper under certain Grocery Store Comparable Leases<sup>39</sup> as well as the leases at the subject property. According to the Respondents, under the Price Chopper lease format at the subject property, the landlord leases the land to the tenant and contributes a fixed dollar per square foot construction allowance which partially defrays the tenant's cost of the construction of the grocery store. The landlord's contribution, however, does not cover all of the costs of construction. It is Respondents' view that since the tenant builds the store, the rent paid by the primary anchor tenant represents a return on the landlord's cost in the land<sup>40</sup>. The Respondents claim that the rent paid by the tenant does not reflect an economic return on all of the improvements at the subject property since a substantial portion of the real estate

improvements are funded by the tenant as a leasehold improvement which excess cost does not enter into the rent negotiation with the landlord.

**Contract Rent Should Be \$14.38 Per Square Foot**

Mr. Herbold asserts that under the Price Chopper format, the landlord's contribution ranged between \$45 and \$46 per square foot<sup>41</sup>. The contract rent paid by Price Chopper of \$10.25 per square foot was based on an amortization of the repayment by Vails Gate to Price Chopper of the sum of \$3,100,000 [ which was the purchase price paid by Price Chopper for the acquisition of the leasehold interest from Waldbaum's<sup>42</sup> ]. According to Respondents, the contract rent of \$10.25 per square foot paid by Price Chopper does not reflect a return on investment or amortization of the, approximately, \$2,800,000 of " fit-up " costs undertaken and paid by Price Chopper [ outside the lease ] to convert the store from the " shell space " delivered by Waldbaum's to the modern grocery store present at the subject property<sup>43</sup>. Mr. Herbold claims that if the construction costs of \$2,800,000 incurred by Price Chopper were amortized at the 7.77% interest rate contained in the leasehold mortgage with United Mutual of Omaha<sup>44</sup> over the 25 year lease term, then the contract rent would be increased by the sum of approximately \$4.13 per square foot<sup>45</sup>. The resulting contract rent, according to Mr. Herbold, would be \$14.38 per square foot.

### **Failure To Adjust For Leasehold Improvements**

It is Respondents' position that the contract rent paid by Price Chopper does not reflect an economic return on the entirety of the real estate improvements at the subject property. Respondents contend that Mr. Beckmann ignored the \$2,800,000 fit up costs and, hence, the contract rent paid by Price Chopper reflects an economic return to the landlord on " half of the box " or half of the physical improvements at the subject property.

### **No Evidence That Monies Were Paid For Improvements**

Petitioners contend, however, that Respondents did not present any evidence that monies were paid for tenant improvements in any of Petitioners' comparables. Petitioners contend that it is typical in the industry that " an allowance " is made by the landlord, that " typically the tenant improvements are paid by the tenant " and that what " codifies the real estate transaction is typically a lease "<sup>46</sup>.

### **Improvements Not Part Of Economic Rent**

It is the Petitioners' view that since no tenant improvements were expressly included in the leases as part of the tenant's fair and reasonable payment, they are not properly part of the economic rent.

Petitioners further state that Mr. Herbold merely speculated when adding the amount spent acquiring the Waldbaum's leasehold interest [ \$3.1 million ] to the \$2.8 million of fit up costs, and, thereby, failed to substantiate his conclusion that a total of \$5.9 million was spent on the property. Petitioners insist that the record is devoid of any evidence to support an actual dollar amount spent on construction costs. The Petitioners assert that since the only document the Respondent provides is a change order from " Storm King Contracting " which specifically states that it is " not valid until signed by the Owner, Architect and Contractor," none of which signed the change order<sup>47</sup>. It is clear that although Mr. Herbold asserts that the cost of construction is a factor related to the valuation of the subject property<sup>48</sup> he does not submit any cost analysis concerning the change order or what monies were actually spent.

#### **Tenant Improvements Not Included in Rental Income**

This Court has recognized that tenant improvements "should be deducted as operating expenses " [ Reckson Operating Partnership L.P., 2 Misc. 3d 1005, 784 N.Y.S.2d 923 ( West. Sup. 2004 )]. Therefore, " leasehold improvements made by tenants should not have been evaluated and included as rental income in respondent's appraisal " [ Ames #82 v.

Board of Review of the Village of Tupper Lake , 173 A.D.2d 943, 945, 569 N.Y.S.2d 818 ( 3d Dept. 1991 )].

### **Expense To Landlord Against Rental Income**

Tenant improvement costs are " a recognized expense for space being re-rented in a building " [ Reckson, supra ]. This is consistent with the view that the Income Approach determines the amount of economic rent the property can produce [ Senpike, supra, at 136 A.D.2d 22 ]. Certainly, tenant improvements are valuable to the tenant, but they represent an expense to the landlord against rental income. Expansion, such as tenant improvements or landlord allowance detracts from the income and thus belongs with the expenses.

### **Half-Box Theory Rejected**

Since a " landlord allowance " is an expense by the landlord against the rental income stream, those sums should not be added to the economic rent, since doing so contradicts the theory of the capitalization of income approach, which seeks to reflect the income that the property is able to produce [ See Senpike, supra, at 136 A.D.2d 22( " the income approach to valuation is based upon an estimate of the economic or market rent for the leased premises " )].

This Court finds that Respondents' " half-box theory " incorrectly included the acquisition cost of a leasehold interest [ the landlord allowance for tenant improvements ] in their valuation of a fee simple. " For tax purposes, the property must be valued as though unencumbered by any lease. It is the real estate that is to be valued and assessed and not the individual interest of the landlord or tenant " [ Senpike, supra, at 136 A.D.2d 23; See also: Merrick Holding Corp. v. Board of Assessors, 45 N.Y.2d 538, 410 N.Y.S.2d 565 (1978)]. Mr. Herbold clearly added a value over and above his economic rent to account for the added value of tenant improvements, under the theory that economic rent only discloses " half the box " <sup>49</sup>.

#### **Respondents' Economic Rent Rejected**

This Court rejects Respondents' method for determining economic rent and adheres to the rule that " income-producing property derives its value from the net income it is able to produce " [ Senpike, supra, at 136 A.D.2d 22 ].

#### **Comparable Taxes**

In determining economic rent "[t]he goal at all times remains full value. To that end, assessors may devise reasonable methods that assure that the income they accept as the basis for capitalization is as close

a reflection of true value as possible " [ Merrick Holding, supra, at 45 N.Y. 2d 542 ]. To that end Mr. Beckmann used the real estate taxes " from the first year the lease was in full effect " and included it in " the base rent figure to come up with an economic rent " <sup>50</sup>. It is the Petitioner's view that the lease would most accurately reflect the market on the day it was signed and that the tenant's obligation on rent, maintenance and real estate taxes are indicative of what he is willing to pay the day the lease was executed.

#### **Looking At The Bottom Line**

Mr. Beckmann testified that he used "numbers that...are verified of what the market participant is doing in his head in appraising. He's looking at what the rent is, what the taxes are, whether it's a 485B exemption, whether there is an IDA involved. He's looking at the bottom line " <sup>51</sup>.

#### **Base Point Market Rent**

Petitioners contend that the further we remove ourselves from this precise market condition the less reliable that negotiated deal becomes. Once " the rent has been arbitrarily set without regard to the market rent value " the veracity of that rental value has diminished

[ Merrick Holding Corp. v. Board of Assessors , 45 N.Y.2d 538, 543, 410 N.Y.S.2d 565 (1978)]. Mr. Beckmann stresses that since the tenants in all of Petitioners' comparable leases agreed to a rental amount on a certain day this is the base point market rent which has to be objectively adjusted by the appraiser.

### **The Assessor's Formula**

Mr. Herbold testified that to determine taxes paid for similar properties he went into the market and looked at other shopping centers in the area<sup>52</sup>. He concluded " based on analysis, that if the landlord were assumed to be paying all of the taxes, that the taxes would be, approximately, \$2.50 a square foot or another \$300,000 a year. So we...performed a gross analysis where we put \$300,000 as...additional income...and applied the assessor's formula to our capitalization rate "<sup>53</sup>. Although Mr. Herbold selected six properties in the Towns of Newburgh and New Windsor and compared taxes,<sup>54</sup> he stated that his asserted " comparable " tax may not have been the taxes in his comparables<sup>55</sup>. In addition, he testified that he chose his gross economic rent " to show what taxes should be per square foot within the market "<sup>56</sup>. Mr. Herbold reasoned that his decision to add an additional \$300,000 to the economic rent was acceptable since " [w]hatever the taxes are each year, the tenant knows that they are going to be responsible for their share "<sup>57</sup>.

### **Failure To Use Actual Taxes**

Mr. Herbold failed to use the actual real estate taxes negotiated under any of his comparable leases, but instead, went into the market to create a " comparable " real estate tax obligation that was never negotiated by landlord or tenant<sup>58</sup>.

### **Fictionalizing The Taxes**

In doing so, Mr. Herbold undermines the veracity of the concept of economic rent by fictionalizing the taxes for each of his comparables. He ignored his own lease comparables and used the taxes on six shopping centers to determine what the taxes " should " be<sup>59</sup>. The result was that Mr. Herbold created a fictional tax obligation as part of his economic rent. Mr. Herbold testified that he made a " tax calculation " based on the premise that " the tenant expects it has to pay the taxes whatever the bill is "<sup>60</sup>.

Accordingly, the Respondents' method of adding \$300,000 to the Gross Income as additional income, labeled as Property Tax Reimbursements, is rejected.

### **Vacancy and Collection Loss Analysis**

Mr. Beckmann concluded a 10% vacancy factor based on the age and functional obsolescence of the subject property<sup>61</sup>. In addition, however, Petitioners' data indicated an overall 12% vacancy rate for retail shopping centers in Orange County<sup>62</sup>.

### **Market Oriented Vacancy**

Mr. Beckmann stated that a " market oriented vacancy " should be utilized<sup>63</sup> relying on Dollars and Cents of Shopping Centers: 2002 and 2004, which he said indicated " older shopping centers running about 15% vacancy rate in 2002, and 20 year old centers running about 11% vacancy rate in 2004 " <sup>64</sup>.

### **Eastern Sector Shopping Centers**

Mr. Herbold selected a 5% vacancy factor after looking at shopping centers in the " eastern Sector " of the United States<sup>65</sup>. Respondents contend that Mr. Beckmann's determination of the vacancy factor is contradicted by both the neighborhood shopping center class<sup>66</sup> and the community shopping center class in the East, both of which carry a 5% vacancy and collection loss factor for the years in question<sup>67</sup>.

### How Old Is Old?

Mr. Herbold admitted that the subject shopping center was 30-35 years old and suffering from some degree of " functional obsolescence ". However he selected the vacancy rate from Dollars and Cents of Shopping Centers, for a shopping center which he viewed as " effectively " fifteen years old<sup>68</sup>. It is Petitioners' view that the subject shopping center must be valued as a 30+ year old shopping center since it was built in 1969<sup>69</sup>.

### Criticism Of Selected Vacancy Rates

Respondents contend that the age factor Mr. Beckmann employed bears no relationship to the subject property they claim has been substantially reconstructed. Respondents also state that the Petitioners' vacancy rate is not credible in light of the full occupancy of the property for both years in question. It is Respondents' position that Petitioners' 10% vacancy and collection rate which was based upon a neighborhood shopping center class for the entire country is directly contradicted by the vacancy rate for neighborhood shopping centers in the East of 5% for 2002 and 2003<sup>70</sup> and 5% for community shopping centers for 2002<sup>71</sup>.

### **8% Vacancy Rate Selected**

After a complete analysis of all factors submitted by Mr. Beckmann and Mr. Herbold, including the age, functional obsolescence and reconstruction of the subject property, the Court determines that an appropriate rate for vacancy and collection loss is 8%.

### **Respondents' Expense Analysis**

When preparing the expense analysis, Mr. Herbold utilized the subject property's operating statements, together with operating data from competing facilities, and data obtained from the Korpacz Real Estate Investor Survey [ " Korpacz " ], Dollars and Cents of Shopping Centers, and other industry sources<sup>72</sup>.

### **Tenant Chargeback For CAM**

Regarding Management/Administrative Expenses, Mr. Herbold used a stabilized management fee of 4%, or \$77,000, equating to \$.63 per square foot of building area. He added Common Area Maintenance [ " CAM " ] in the amount of \$150,000 to the economic rent as a " tenant chargeback for CAM ", and took the same \$150,000 as an expense to the property<sup>73</sup>. According to operating statements, certain costs for repairs and

maintenance were not recoverable as a CAM reimbursement, and, therefore, the reported two year average cost of \$6,000 was included by Mr. Herbold as a non-recoverable repair and maintenance line item expense<sup>74</sup>.

### **Insurance Expense**

As to the insurance expense, the Respondents used the two year average reported insurance cost of \$37,000. This equates to approximately 2% of effective gross annual income, or \$.30 per square foot, which is consistent with Dollars and Cents of Shopping Centers' average insurance cost of \$.22 per square foot for community shopping centers<sup>75</sup>.

### **Legal & Miscellaneous Expenses**

The Legal/Professional/Administrative expense was stabilized at 1.5% of the effective gross income. As to miscellaneous expenses, Mr. Herbold chose a nominal allowance of .5% of the effective gross income.

### **Replacement Reserve Funds**

Regarding Reserves for Replacement and Leasing Commissions, Mr. Herbold did not include these items as a line-item expense. He stated in his appraisal that the subject's financial statements do not classify

an expense for a replacement reserve fund. Consequently, he claims, no historical expenses are available<sup>76</sup>. " As a result, we have considered industry data published by *Korpacz*, which indicate that with most retail properties, reserves for replacement, together with leasing commissions, were considered a below-the-line expense. Based upon this study, we have not included reserves or leasing commissions as a line-item expense "<sup>77</sup>.

### **Petitioners' Expense Analysis Rejected Except For Reserves And Leasing Commissions**

There are several problems with the Petitioners' expense analysis. First, the overall level of expenses contained in the Petitioners' appraisal [ i.e., \$3.89/SF for 2002 and \$4.46/SF for 2003 ] is more than double the actual level of expenses incurred at the subject property<sup>78</sup> and is, approximately, one and one-half times the comparable industry expense data contained in the Petitioners' appraisal<sup>79</sup>.

### **Double Counting Management Fees**

Second, Mr. Beckmann double counted the management fee expense within the industry and comparable CAM expense categories, which did include some level of management fees<sup>80</sup>. The listed comparable

neighborhood shopping centers<sup>81</sup> and industry surveys<sup>82</sup> all include some level of management fees.

### **Community & Neighborhood Shopping Centers**

Third, Mr. Beckmann certified that the use of the subject property is a "community shopping center" in the zoning and highest and best use analysis<sup>83</sup>. However, in spite of Mr. Beckmann's conclusion that the existing use of the subject property was as a "community shopping center" his appraisal changed the classification of the subject property to a "neighborhood shopping center" for the purpose of determining all categories of expenses<sup>84</sup>. On cross examination, Mr. Beckmann confirmed that neighborhood shopping centers cost more per square foot to operate than do community shopping centers<sup>85</sup>.

### **Non-Reimbursement Expenses**

Fourth, the non-reimbursable and miscellaneous expense category deduction of \$60,675 in Petitioner's appraisal has no express delineation of the expenses included in the category or any supporting documentation that corroborate this expense deduction. Although Mr. Beckmann stated that a portion of this category represented leasing commissions, the deduction of \$.50/SF is contradicted by the industry data of \$.21/SF for 2002<sup>86</sup> and \$.19/SF for 2003<sup>87</sup>. Moreover, this expense

category ignores the fact that the subject property has not had any vacancy from 2001 to 2006 so that the leasing commissions and build out expenses would not have been paid<sup>88</sup>.

### **Miscellaneous Expenses**

Fifth, the miscellaneous expense category is also directly contradicted by expense documentation for the comparable properties contained in the Petitioners' appraisal<sup>89</sup>.

### **Replacement Reserve Funds**

Sixth, regarding Reserves for Replacements and Leasing Commissions, Mr. Beckmann utilized 5% of gross income for reserves for replacement " for anticipated outlays to restore or replace short-lived capital items "<sup>90</sup>. Respondents' appraisal implies that these reserves for replacement and leasing commission expenses are accounted for in their ultimate capitalization rate.

### **Below The Line**

Mr. Herbold testified that these expenses are " below the line. That is, they're not treated as an expense. They're treated as a deduction from the capitalization value of the property in accordance

with the way market investors operated these properties "91. Respondents' testimony and appraisal, however, are completely devoid of any specific adjustments or calculations that were made to reflect these expenses.

### **Above The Line**

This Court has held that certain reasonably expected expenses should be reflected in an income approach analysis " on a stabilized basis over the course of an investment " where an owner would have to incur that expense and therefore should be treated as " above the line " [ Reckson Operating Partnership L.P. v Town of Greenburgh, 2 Misc. 3d 1005, 784 N.Y.S.2d 923 ( West. Sup. 2004)]. Clearly, since replacement of long-term items and leasing commissions will be incurred in the normal course of business, these are legitimate expenses to be anticipated by the reasonable investor.

This Court rejects Petitioners' expense analysis with the exception of that portion relating to replacement reserves and leasing commissions and otherwise accepts Respondents' expense analysis.

## Capitalization Rate

### Petitioners' Selection Of Non-Institutional Rates

To determine the capitalization rate, Mr. Beckmann relied upon Korpacz, and reviewed the " non-institutional " rates for strip shopping centers. Mr. Beckmann determined that the subject property was not considered an institutional grade property and is an older property in direct competition with newer shopping centers with modern amenities<sup>92</sup>. According to Mr. Beckmann, " a prudent investor will most likely choose a capitalization rate that recognizes the added risk associated with owning an older " lower grade " property "<sup>93</sup>. Hence, Mr. Beckmann determined that based on the age and condition of the subject shopping center, the correct capitalization rate is 11.75% for 2002 and 11.00% for 2003. Following the addition of the effective tax rates of 2.84% for 2002 and 2.79% for 2003, the overall capitalization rate was determined by Mr. Beckmann to be 14.51% for 2002 and 13.67% for 2003.

### Respondents' Three Methodologies

Mr. Herbold utilized three methodologies to develop a capitalization rate<sup>94</sup>.

### **Market Extraction Method**

First, he used a " market extraction " method by looking at the sales of comparable properties with known net operating income and dividing it by the sales price<sup>95</sup>. His conclusions for this method were 10.50% for 2002 and 10.50% for 2003.

### **Institutional Grade Properties**

For his second and third methods, Mr. Herbold utilized Korpacz, and deemed the subject property an " institutional grade " property. Although the Korpacz " institutional grade " rates were 9.98% for 2002 and 9.58% for 2003, Mr. Herbold concluded a capitalization rate below the "institutional investor" by Korpacz and selected the capitalization rates for the subject property of 9.75% for 2002 and 9.50% for 2003<sup>96</sup>. Following the addition of an effective tax rate of 2.84% for 2002 and 2.79% for 2003, the Respondents' overall capitalization rate for the subject property was determined to be 12.59% for 2002 and 12.29% for 2003<sup>97</sup>.

### **Factors In Selecting Institutional Grade**

Mr. Herbold's decision to choose an institutional grade capitalization rate for the subject property was based on a variety of

factors. Mr. Herbold contends that Price Chopper is considered to be an institutional investment grade property " since it has the financial strength of an investment grade rating " <sup>98</sup>. Mr. Herbold based this on two market transactions made by institutional investors with respect to the subject property. The first was the purchase by Price Chopper of Waldbaum's leasehold interest for \$3,100,000 <sup>99</sup>. The second was the \$4,400,000 mortgage loan made by Mutual of Omaha Life Insurance Company to Vail's Gate for the subject property <sup>100</sup>, relying in part on Mr. Beckmann's testimony that an institutional investment could be both debt or equity <sup>101</sup>.

### **Korpacz Factors**

In addition, Respondents contend that the subject property is an institutional investment grade property since it falls within certain Korpacz factors, such as the property being readily re-leased to a credit worthy tenant, which occurred when Golub purchased the leasehold interest in the subject property in 1995 for \$3,100,000 <sup>102</sup>; that there is good long-term growth in that the immediate area has been improved with approximately 500 new homes <sup>103</sup>; and that it has a stable occupancy by a preponderance of strong tenants since 78.38% of the property is leased by national and regional tenants. In addition, Mr. Herbold claimed that the property has had a substantial level of equity investment made by its tenants <sup>104</sup>, that the property is located in a

submarket, it is a large size center at a good location with above average architectural design and modern mechanical systems, it has good adjacent parking, and is " brochure quality " due to its selling price of approximately \$12,000,000<sup>105</sup>.

#### **Appropriate Capitalization Rate Selected**

After considering all of the factors presented by the parties, this Court determines that, although the subject property contains many factors consistent with an institutional grade property, it does not reach the level of institutional grade. Hence, in determining the appropriate capitalization rate to be used, we reject the capitalization rates of both Mr. Beckmann and Mr. Herbold. The Court finds that the appropriate capitalization rate for the tax years in question to be 13.8% for 2002 and 13.3% for 2003.

The Fair Market Value Of The Subject Property

The range of testimony supports the following income, expenses and Fair Market Values of the subject property:

	<u>2002</u>	<u>2003</u>
Rental Income	\$1,633,984.	\$1,665,221.
CAM	150,000.	150,000.
Vac. & Coll. Loss (8%)	130,719.	133,218.
Expenses	393,451.	393,451.
Cap. Rate	13.8%	13.3%
Fair Market Value	9,129,087.	9,688,368.

The Proper Assessed Values

Applying the respective equalization rates [ 21.66% for 2002 and 19.21% for 2003 ] to the indicated Fair Market Values produces the indicated assessed values as follows:

<u>Year</u>	<u>Rate</u>	<u>Assessed Value</u>
2002	21.66%	\$1,977,360.
2003	19.21%	\$1,861,136.

The Ordered Reduction

<u>Year</u>	<u>Assessment</u>	<u>Indicated Assessment</u>	<u>Reduction</u>
2002	\$2,167,600.	\$1,977,360.	\$190,240.
2003	\$2,167,600.	\$1,861,136.	\$306,464.

The petitions, with costs [ RPTL 722(1) ], are sustained to the extent indicated above, the assessment rolls are to be corrected accordingly, and any overpayments of taxes are to be refunded with interest.

The foregoing constitutes the Decision and Order of this Court.

Dated: White Plains, N.Y.  
October 5, 2006

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HON. THOMAS A. DICKERSON  
JUSTICE SUPREME COURT

TO: Matthew J. Cronin, Esq.  
Cronin, Cronin & Harris, P.C.  
Attorneys For Petitioners  
200 Old Country Club Road, Suite 570  
Mineola, N.Y. 11501

Paul J. Goldman, Esq.  
Segal, Goldman, Mazzotta & Siegel, P.C.  
Attorneys For Respondents  
9 Washington Square  
Albany, N.Y. 12205

## ENDNOTES

1. See Midway Shopping Center v. The Town of Greenburgh, 11 Misc. 3d 1071 ( West. Sup. 2006 )( " Stated, simply, Midway, the owner of the subject property and solely responsible for paying real property taxes to the Respondent Town for the tax years 1998, 1999, 2000, 2001 and 2002, never filed a complaint before the BAR, never filed a Property Appearance Form before the BAR, never filed an RPTL Article 7 Petition, never served and filed verified or certified income and expense statements pursuant to 22 NYCRR §§ 202.59(b),(d)(1) and never served and filed Notes of Issue herein. For all of these reasons Midway has no RPTL Article 7 claim against the Respondents for the tax assessments imposed in 1998, 1999, 2000, 2001 and 2002. " ).

2. For discussions of valuing shopping centers see The Appraisal of Real Estate, Appraisal Institute, Chicago, 12<sup>th</sup> Edition ( 2001 ) at pp. 178-182; Lennhoff, A Business Enterprise Value Anthology, Appraisal Institute, Chicago ( 2001 ) at pp. 149-253.

3. Petitioners' Memorandum of Law dated June 22, 2006 [ " P. Memo. " ], Respondents' Post Trial Memorandum of Law dated June 16, 2006 [ " R. Memo. " ], Petitioners' Reply Memorandum of Law dated July 20, 2006 [ " P. Reply Memo. " ], Respondents' Post Trial Reply Memorandum of Law dated July 21, 2006 [ " R. Reply Memo. " ].

4. Petitioners' Findings of Fact and Conclusions of Law dated July 21, 2006 and Respondents' Findings of Fact and Conclusions of Law dated July 21, 2006.

5. P. Ex. 1 at p. 53.

6. R. Ex. K.

7. R. Exs. D & E.

8. R. Ex. B.

9. R. Ex. B.

10. R. Ex. C.

11. R. Ex. A at pp. 96-97.

12. R. Ex. I.

13.T. Rec. [ 1/30/2006 ] at pp. 5-6.

14.T. Rec. [ 1/30/2006 ] at p. 6 ( \$130.91 per \$1000 in 2002 and \$145.37 per \$1000 in 2003 ).

15. See e.g., Orange And Rockland Utilities, Inc. v. Assessor of the Town of Haverstraw, 12 Misc. 3d 1194 ( Rockland Sup. 2006 ) ( " Having established a valuation floor, it is necessary to establish a valuation ceiling, above which this Court may not go. The Town's equalized full value figures are as follows " ); Mirant New York, Inc. v. Town of Stony Point Assessor, 13 Misc. 3d 1204 ( Rockland Sup. 2006 ) ( " We found it useful in determining the true value of Bowline to begin our analysis by constructing a valuation floor and ceiling based upon several well accepted principals. First, the Petitioners and Respondents are bound by their admissions of reconciled values in their respective appraisals for each year under review. Second, the Petitioners are bound by their full value figures set forth in their Petitions but only to the extent [ as in Bowline but not herein ] that they are greater than the admissions of value which appear in their appraisal. " ); Orange and Rockland, Inc. v. Assessor of the Town of Haverstraw, 7 Misc. 3d 1017, 801 N.Y.S. 2d 238 ( Rockland Sup. 2005 ) ( " Petitioners sought ` to amend its petitions [ for the years 1995 through 2003 ] to conform them to the proof of the fair market value opined by ( Mirant's ) appraiser at trial ` " ).

16.R. Ex. A at p. 89.

17.P. Ex. 1.

18.P. Ex. 1 at pp. 78-79, 88-89, 98-99, 111-113.

19.P. Ex. 1 at pp. 117-128.

20.T. Rec. [ 4/14/2006 ] at pp. 32-35, 155.

21.T. Rec. [ 4/14/2006 ] at p. 155.

22.P. Ex. 1 at p. 66; R. Ex. A. at p. 34.

23.P. Ex. 1 at p. 65.

24.R. Ex. A at p. 88.

25.R. Ex. A at p. 71.

26. R. Ex. A at p. 71.
27. **P. Ex. 1 at p. 137.**
28. R. Ex. A at p. 89.
29. T. Rec. [ 1/30/2006 ] at pp. 46-47.
30. T. Rec. [ 1/30/2006 ] at pp. 47-48.
31. T. Rec. [ 1/30/2006 ] at p. 46; P. Ex. 1 at pp. 127-130.
32. R. Ex. A at pp. 40-58.
33. R. Ex. A at pp. 58-59.
34. T. Rec. [ 1/31/2006 ] at p. 255.
35. T. Rec. [ 1/31/2006 ] at p. 271.
36. T. Rec. [ 1/31/2006 ] at p. 195.
37. T. Rec. [ 1/31/2006 ] at p. 195.
38. R. Rec. [ 1/31/2006 ] at p. 262.
39. R Ex. A at pp. 75-76.
40. P. Ex. 1 at pp. 74-75.
41. R Ex A at pp. 75-76 ( Grocery Store Comparables 3 and 4 ).
42. R. Ex. E.
43. P. Ex. 1 at pp. 96-97.
44. R. Ex. I.
45. T. Rec. [ 4/14/2006 ] at p. 263(15-25).
46. T. Rec. [ 1/31/2006 ] at pp. 191-192, 195.
47. R. Ex. A at pp. 96-97.
48. T. Rec. [ 1/31/2006 ] at p. 262.

49. T. Rec. [ 1/31/2006 ] at pp. 259, 267-269; T. Rec. [ 4/14/2006 ] at p. 195; R. Ex. A at p. 39.
50. T. Rec. [ 1/30/2006 ] at p. 166.
51. T. Rec. [ 1/30/2006 ] at p. 177.
52. T. Rec. [ 1/31/2006 ] at p. 274.
53. T. Rec. [ 1/31/2006 ] at p. 274.
54. R. Ex. A. at p. 110.
55. T. Rec. [ 1/30/2006 ] at pp. 163-164.
56. T. Rec. [ 4/14/2006 ] at p. 88.
57. T. Rec. [ 4/14/2006 ] at p. 167.
58. T. Rec. [ 1/30/2006 ] at pp. 273-274; T. Rec. [ 4/14/2006 ] at pp. 164-165; R. Ex. A at p. 59.
59. T. Rec. [ 1/30/2006 ] at p. 166.
60. T. Rec. [ 4/14/2006 ] at pp. 165-166.
61. T. Rec. [ 1/30/2006 ] at pp. 60,112,118.
62. P. Ex. 1 at p. 126.
63. T. Rec. [ 1/30/2006 ] at p. 118.
64. P. Ex. 1 at p. 126; T. Rec. [ 1/30/2006 ] at p. 119.
65. T. Rec. [ 1/30/2006 ] at pp. 275-276; R. Ex. A at pp. 60-61.
66. R. Ex. A at pp. 149, 152.
67. P. Ex. 1 at p. 126; R. Ex. A at p. 60.
68. T. Rec. [ 1/30/2006 ] at p. 256; T. Rec. [ 4/14/2006 ] at p. 91.
69. R. Ex. A at p. 20; T. Rec. [ 1/31/2006 ] at p. 256.
70. P. Ex. 1 at p. 126.

71.R. Ex. A at p. 60.

72.R. Ex. A at p. 60.

73.R. Ex. A at p. 59.

74.R. Ex. A at p. 61.

75.R. Ex. A at p. 61.

76.R. Ex. A at p. 61.

77.R. Ex. A at p. 61.

78.R. Ex. A at p. 62 ( \$1.68/SF for 2002 and \$2.05/SF for 2003 ).

79.P. Ex. 1 at p. 150 ( Total Operating Expense \$3.93 minus Real Estate Taxes \$1.50 = \$2.43/SF for 2002 ); and at p. 153 ( Total Operating Expense \$4.18 minus Real Estate Taxes \$1.54 = \$2.64 for 2003 ).

80.P. Ex. 1 at pp. 1180120 ( \$36,000 or \$.30/SF ).

81.P. Ex. 1 at pp. 121-125.

82.P. Ex. 1 at pp. 150-153.

83.P. Ex. 1 at pp. 57, 63.

84.P. Ex. 1 at pp. 57, 63, 117, 126-127.

85.T. Rec. [ 1/30/2006 ] at p. 123; T. Rec. [ 1/31/2006 ] at pp. 276-277; T. Rec. [ 4/14/2006 ] at p. 197.

86.P. Ex. 1 at p. 150.

87.P. Ex. 1 at p. 153.

88.T. Rec. [ 4/14/2006 ] at p. 275.

89.P. Ex. 1 at p. 121 ( \$50 Brotherhood Shopping Center ), p. 123 ( \$169 and \$97 Rosman Road Center ), p. 124 ( \$2,000 and \$0 for Indian Rock Shopping Center ), and p. 125 ( \$100 Wesley Hills Plaza ).

90. T. Rec. [ 1/30/2006 ] at p. 64; P. Ex. 1 at p. 129.
91. T. Rec. [ 1/30/2006 ] at p. 289; R. Ex. A at p. 107.
92. P. Ex. 1 at p. 132.
93. P. Ex. 1 at p. 132.
94. R. Ex. A at p. 69; T. Rec. [ 1/31/2006 ] at p. 292.
95. T. Rec. [ 1/31/2006 ] at p. 293.
96. R. Ex. A at p. 69.
97. R. Ex. A at p. 70.
98. T. Rec. [ 4/14/2006 ] at p. 183.
99. R. Ex. E.
100. R. Ex. I.
101. T. Rec. [ 1/30/2006 ] at pp. 78-79.
102. R. Ex. E.
103. R. Ex. A at p. 15.
104. R. Ex. A; T. Rec. [ 1/31/2006 ] at pp. 252-253.
105. T. Rec. [ 4/14/2006 ] at pp. 122,123,125.