

NO. CV 08 4021509S : SUPERIOR COURT

STOP & SHOP SUPERMARKET
COMPANY : JUDICIAL DISTRICT OF
: NEW BRITAIN

v. :

CITY OF DANBURY : AUGUST 17, 2010

CORRECTED MEMORANDUM OF DECISION

The plaintiff, Stop & Shop Supermarket Company (Stop & Shop) brings this six-count amended complaint contesting the valuation placed upon two of its properties located in the city of Danbury (city) for the revaluation year of October 1, 2007 and the subsequent Grand List years of 2008 and 2009. The two properties that are the subject of this appeal are 70 Newtown Road (Newtown Road) and 44 Lake Avenue Extension (Lake Avenue).

The Newtown Road property consists of a 9.73 acre parcel of land located on the westerly side of Newtown Road in the city's east central section. The property consists of a one-story, multi-tenant neighborhood shopping center known as Nutmeg Square. It contains approximately 91,895 square feet of gross leasable area that includes a 59,743 square-foot Stop & Shop regional supermarket and 32,152 square feet of satellite store space. There are 447 parking spaces on-site. The center was originally constructed in 1980 and has since been renovated. As of October 1, 2007, the center was 100% leased to multiple tenants.

Nutmeg Square, LLC acquired the Newtown Road property on April 28, 1997. In 1983, Stop & Shop entered into its original lease with the previous landlord. The original lease contained a provision and amendments thereto to reimburse the landlord for real estate taxes on the subject premises with the right to contest, in its name or in the name of the landlord, any assessment or taxes imposed on the Newtown Road property.

As of October 1, 2007, the following valuations of the Newtown Road property were determined:

City's assessor	\$16,238,200
City's appraiser (Joseph Dondiego)	\$14,600,000
Plaintiff's appraiser (Sean T. Hagearty)	\$14,500,000

Dondiego's valuation was originally based upon the use of the income approach and sales comparison approach in arriving at a fair market value of \$15,000,000, as of October 1, 2007. In reaching this conclusion, as applied to the income capitalization approach, Dondiego developed a net operating income (NOI) of \$1,308,803 to which he applied an 8.75% capitalization rate, including the tax factor of 1.49%. See defendant's Exhibit D, pp. 49-50. Dondiego reduced his final valuation from \$15,000,000 to \$14,600,000 due to a \$415,000 miscalculation. See defendant's Exhibit E.

Given the complexity in determining the fair market value of the subject multi-tenant property based upon the income capitalization and the sales comparison approaches, it is important to recognize that the appraisers' valuation calculations are, for all practicable purposes, minimally apart.

Upon review of both appraisal reports, it is more credible to accept Hagearty's valuation of \$14,500,000 as the fair market value of the Newtown Road property, as of October 1, 2007. Accordingly, the valuation of the real estate located at 70 Newtown Road is reduced from \$16,238,200 to \$14,500,000.

Turning to the Lake Avenue property, both Hagearty and Dondiego are approximately \$5,000,000 apart in their appraisal as of the last revaluation date of October 1, 2007.

As of October 1, 2007, the following valuations of the Lake Avenue property were determined:

City's assessor	\$13,444,900
City's appraiser (Joseph Dondiego)	\$15,200,000
Plaintiff's appraiser (Sean T. Hagearty)	\$10,500,000

The Lake Avenue property is a 5.41 acre parcel of land improved with a one-story Stop & Shop regional supermarket containing 60,250 square feet of gross leasable area. The building was constructed in 1989 and has been renovated periodically.

Hagearty notes that "Danbury is serviced by an extensive highway network. Interstate 84 bisects the town in a generally east to west fashion and there are multiple interchanges within the city limits. The city is bisected in a generally north/south direction by CT Route 7. This highway links northern Fairfield County with southern Fairfield County and provides linkages to the Merritt Parkway a/k/a US Route 15, and Interstate 95. In addition to those major roadways, the city also has an extensive network

of secondary U.S. and state highways such as U.S. Route 6. In addition to the highway network, the city also has access to the Metro-North commuter train lines, which has allowed the city to continue to grow in popularity as a bedroom community for residents in the metro New York region.” (Plaintiff’s Exhibit 6, p. 9.)

Of particular significance is Hagearty’s overview of the city’s commercial/retail base. Hagearty reported that “Fairfield County contains about 25% of the state’s population and households but has about 30% of the state’s total household income. As could be expected, the demand for retail goods and other services is quite high in Fairfield County. Given the city of Danbury’s extensive and diversified population base, its access to major highways linking all area towns to it, the city has developed a very sizable commercial base and continues to function as a hub for the surrounding towns.” (Plaintiff’s Exhibit 6, p. 12.)

Dondiego noted that Fairfield County is the most affluent county in Connecticut. “The County’s population, for the most part, is prosperous and well-educated, and many residents live in some of the nation’s most affluent neighborhoods. Geographic location along the I-95 corridor and within close proximity to both Manhattan and Hartford make Fairfield County an ideal place to do business Fairfield County is also recognized for having excellent public and private elementary and secondary school systems, including Greenwich, Darien, New Canaan, and Westport. In addition, the County is home to several institutions of higher learning most notably Fairfield University, Sacred

Heart University, and University of Connecticut's Stamford campus." (Defendant's Exhibit A, p. 12.)

Dondiego further noted that "Danbury is an extremely attractive retail location within . . . Connecticut. It was reported that in 2000 . . . Danbury led the State in producing the highest amount of total retail sales. . . . Danbury was able to achieve this status primarily due to the presence of the Danbury Fair Mall and big-box development along Federal Road. These two corridors are the primary retail areas within the Greater Danbury region. Secondary retail corridors include Newtown Road and Mill Plain Road/Lake Avenue Extension." (Defendant's Exhibit A, p. 15.) The subject property is located in the Mill Plain Road/Lake Avenue Extension corridor.

It is necessary to consider the vibrant economic character of the Danbury area as both appraisers largely selected comparables outside of affluent Fairfield County. For the sales approach, Dondiego selected Stop & Shop supermarket sales in Southington and Manchester and Shaw's supermarket sales in Bridgeport and Shelton.

Hagearty's six sales consisted of the following supermarket properties:

Stop & Shop, Manchester (*same as Dondiego*)

Stop & Shop, Berlin Turnpike, Wethersfield

Shaw's, Bridgeport (*same as Dondiego*)

Shaw's, Enfield

Shaw's, West Hartford

Price Chopper, Berlin Turnpike, Newington (with Dick's sports store attached).

See plaintiff's Exhibit 6, p. 39.

Both appraisers selected a freestanding Shaw's supermarket in Bridgeport which was sold on September 27, 2005 for \$15,275,000. This supermarket has 54,425 square feet of gross leasable area. Although Dondiego reported that this sale had a 100% occupancy at the time of sale, Hagearty noted that Shaw's vacated the building in 2007 and the space was offered for sublease.

Hagearty's second freestanding sale was a Shaw's supermarket on Prospect Avenue in West Hartford. This supermarket was sold on April 1, 2005 for \$21,250,000. It has 141,049 square feet of gross leasable area. Hagearty further noted that "[i]t is difficult to find truly analogous comparable sales for the subject given the specific fee simple property rights appraised. Sales 1 and 2 are physically the most analogous to the subject as they are freestanding grocery stores. However, each of these properties is net leased to a national chain for an extended lease term. That is, they represent the leased fee interest, not a fee simple interest which is the specific property rights being appraised for this tax appeal." (Plaintiff's Exhibit 6, p. 40.) This comment raises the question of whether the net leases were representative of the market because of the close affiliation of the parties to the lease.

Turning to the income approach to value, Dondiego commented that "[w]e have given most weight to the Income Capitalization Approach because this mirrors the methodology used by purchasers of this property type." (Defendant's Exhibit A, p. 48.)

For reasons expressed by both appraisers, it is most credible for the court to base its finding of value on the income capitalization approach to value.

Although Dondiego went through the process of seeking to determine what the market rent was for the Lake Avenue property, as of October 1, 2007, he ended up concluding that the contract rent of \$1,442,066 equaled the market. See defendant's Exhibit A, p. 39.

Dondiego, using the total potential gross revenue of \$1,442,066, arrived at effective gross revenue of \$1,398,804 by deducting a vacancy and collection loss of 3%, or \$43,262, from \$1,442,066. Deducting operating expenses of \$107,113, Dondiego concluded that the subject's NOI was \$1,291,692, or \$21.44/SF. See defendant's Exhibit A, p. 45. Using NOI of \$1,291,692 with a capitalization rate of 8.5%, Dondiego made a final conclusion of value of \$15,196,371, rounded to \$15,200,000. See defendant's Exhibit A, pp. 47-48.

In developing the market rent of \$17/SF, Hagearty arrived at a potential gross income of \$1,024,250 ($\$17/\text{SF} \times 60,250 \text{ SF}$). See plaintiff's Exhibit 6, p. 34. From this amount, Hagearty deducted a vacancy/collection loss factor of 6%, or \$61,455, to arrive at an effective gross income of \$962,795. On balance, it is more credible to use Dondiego's 3% vacancy/collection loss rate rather than Hagearty's 6% rate because there is a very low vacancy risk for such a quality, single tenant like Stop & Shop. Furthermore, as of the revaluation date, the subject Lake Avenue supermarket is located in a highly

desirable retail area. Hagearty's 6% vacancy factor is simply too high for such a low vacancy and collection risk.

In developing his NOI, Hagearty concluded that there were \$101,739 in total operating expenses and this amount was deducted from his effective gross income of \$962,795, to arrive at NOI of \$861,056. For all practical purposes, Hagearty's operating expense total is the same as Dondiego's. It appears that the difference in valuation between Hagearty's and Dondiego's calculations is with the development of each appraiser's effective gross income.

The initial difference comes from the market rent for the Lake Avenue property, as of October 1, 2007, with Hagearty's market rent of \$17/SF and Dondiego's market rent of \$23.93/SF, a difference of approximately \$7/SF. However, when considering the market rent, both Hagearty and Dondiego acknowledged that the Stop & Shop lease running from 1989 to 2015 had a current base rent, as of the revaluation date, of \$1,237,966 or \$20.55/SF NNN. Hagearty and Dondiego further noted that the tenant also paid additional rent of \$205,075 or \$3.40/SF as total expense reimbursement. See plaintiff's Exhibit 6, p. 24 and defendant's Exhibit A, p. 42. The appraisers' total rent figure of \$1,443,041 is also the income amount that Stop & Shop reported on its 2007 Annual Income and Expense Report Summary filed with the city's assessor. See defendant's Exhibit B.

In determining the value of the subject property, as of the revaluation year of October 1, 2007, General Statutes § 12-63 (a) directs the court to find the “fair market value” of the property.¹

When considering the issue of fair market value, General Statutes § 12-63b (b) directs that the contract rent of Stop & Shop be a consideration in developing the valuation of rental income real property.² See Pilot’s Point Marina, Inc. v. Westbrook, 119 Conn. App. 600, 603-604, 988 A.2d 897 (2010).³ As noted in Pepsi-Cola Bottling Co. v. Bd. of Assessors, 397 Mass. 447, 451, 491 N.E.2d 1071 (1986), “[t]he use of actual rents is an

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General Statutes § 12-63 (a) provides, in relevant part, as follows: “The present true and actual value of all other property shall be deemed by all assessors and boards of assessment appeals to be the fair market value thereof and not its value at a forced or auction sale.”

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General Statutes § 12-63b (b) recites 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.”

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The Pilot’s Point court noted that “[p]ursuant to § 12-63b (b), the court is required to consider both market rent and actual rent when determining fair market value using the income capitalization method. . . . Moreover, if the property is devoted to the use for which it is best adapted and is in a condition to produce or is producing its maximum income, the actual rental is a very important element in ascertaining its value. Consequently, in light of the actual income generated by the property through summer boat storage, the [trial] court’s failure to include any summer storage income in its final EGI calculation was improper.” (Internal quotation marks omitted.)

acceptable method of valuation as long as they adequately reflect earning capacity. . . .

There must be a relation to market rental value.”

To determine whether the plaintiff’s contract rent represents the fair rental market for property of this type, consistent with the statutory requirement, it is necessary to consider what that market rent was as of October 1, 2007, to develop a potential gross income as an element in the appraisal process. For example, “[t]he shopping center’s total potential gross income depends on trends in the number of households in the trade area, the income of these households, and their typical expenditures on the goods and services supplied by these households, and their typical expenditures on the goods and services supplied by the center’s tenants; the availability of alternative shopping facilities also must be considered.” *The Appraisal of Real Estate* (12th Ed. 2001) p. 135.

Looking at the rental market from Hagearty’s viewpoint, Hagearty considered four grocery stores located in areas he generally described as “Central CT”, “Route 83, Somers”, “Eastern CT”, “Hartford County” and a “[f]ormer Ames space in a large shopping center near the West Hartford/Hartford lines[.]” (Plaintiff’s Exhibit 6, p. 25.)

In his testimony in court and in his appraisal report (see plaintiff’s Exhibit 6, p. 25), Hagearty made a deliberate effort to protect the confidentiality of these so-called comparables by withholding pertinent information about these grocery stores. Hagearty described the rental market for grocery stores in eastern and central Connecticut in quite different terms from those in Fairfield County (i.e., trade areas, household income and expenditures). Furthermore, Hagearty found a range of \$9 to \$21.09/SF NNN which may

represent the rental market in eastern and central Connecticut, but certainly not the rental market for the Lake Avenue property in Fairfield County.

Hagearty lists another three supermarket/grocery store spaces on the rental survey (see plaintiff's Exhibit 6, p. 26) located at 1045 West Main Street, New Britain; 500 Sylvan Avenue, Bridgeport; and 205 Union Street, Waterbury. Again, New Britain and Waterbury represent a different retail rental market from Fairfield County. As to the supermarket property at 500 Sylvan Avenue in Bridgeport, Hagearty points out the problem using this comparable: "This is a freestanding grocery store property that was constructed on a build-to-suit basis for Shaw's in 1998. Shaw's vacated the premises and the space was offered for sublease for the remaining 15 years of the original lease term for \$18/SF NNN 'as is'. A sublease was reportedly negotiated in late 2007 for around \$12/SF NNN but the tenant has yet to take occupancy and the space is still being offered for sublease." (Plaintiff's Exhibit 6, p. 26.) This comparable, in its present state, does not represent the market.

In addition to surveying rentals outside of Fairfield County, Hagearty also noted "that there have been four new grocery stores that have opened in the subject's market area since the subject lease commenced in 1989. These include the 1998-built A & P facility on Padanaram Road, the Trader Joe's on Mill Plain Road in the center that is part of the western part of the subject's immediate area, the Stew Leonard's facility in the Federal Road area and the new Big Y. . . . Any prospective future tenant for the subject would certainly have to take the increased level of potential competition into account in analyzing

a potential market rent as of October 1, 2007. The fact that the current tenant renovated the space subsequent to the effective date of this appraisal to remain competitive in the market bears this out.” (Plaintiff’s Exhibit 6, p. 24.)

Hagearty’s market rent conclusion is reflected in the following comments:

“The subject is a freestanding store and offers a very strong location. On the other hand, it is 18-years-old and if it were to be offered for lease as of the effective date of this appraisal, the high level of market competition from some newer stores in the market area would be a major factor. For these reasons, a market rent in the \$15 to \$18/SF NNN is reasonable. This range is also well-supported by the current asking rents for the former Shaw’s sites in Bridgeport and Waterbury and the additional retail rental comparables other than grocery stores which were considered.

“All things considered, market rent of \$17/SF on a triple net basis is appropriate for the Stop & Shop space. This rate reflects on the subject’s age, size and location relative to the comparables surveyed. It is a little lower than the market rents for new spaces surveyed but is much higher than many of the others given the superior northern Fairfield County location of the subject.”

(Plaintiff’s Exhibit 6, p. 30.)

Hagearty’s valuation of the subject property at \$17/SF is based, in part, on the subject property being 18-years-old and in competition with newer stores. This is inconsistent with his finding that the subject property has been kept up-to-date with periodic renovations in order to keep current with area competition.

Dondiego, in considering the rental market for the subject property, defined the trade area as follows:

“A retail center’s trade area contains people who are likely to patronize that particular center. These customers are drawn by a given class of goods and services from a particular tenant mix. A center’s fundamental drawing power comes from the strength of the anchor tenants, as well as the regional and local tenants, which complement and support the anchors. A successful combination of these elements creates a destination for customers seeking a variety of goods and services while enjoying the comfort and convenience of an integrated shopping environment.” (Defendant’s Exhibit A, p. 20.)

Dondiego further described competitive supermarkets as follows:

“In order to help establish the boundaries of the subject’s potential trade area, we must review the nature of the area retail structure in which it competes. In addition, local and regional transportation patterns, geographic constraints, and area development trends all help to place the subject’s primary and secondary trading areas into a definable context. The following chart presents the supermarkets we identified as being the most directly competitive with the property appraised.” (Defendant’s Exhibit A, p. 20.)

Dondiego listed the following competing supermarkets:

1. A&P Super Foodmart, 1 Padanaram Road, Danbury
2. Super Stop & Shop, 70 Newtown Road, Danbury
3. Trader Joe’s, 113 Mill Plain Road, Danbury
4. Stew Leonard’s, 99 Federal Road, Danbury

5. Shop-Rite, 143 Federal Road, Brookfield

See defendant's Exhibit A, p. 21.

However, all of Dondiego's comparables are located outside the highly desirable Fairfield County market area. In arriving at a conclusion as to the subject's market rent, Dondiego relied on the rental activity for the following properties:

1. Super Stop & Shop, Bristol
2. Big Y, North Haven
3. Super Stop & Shop, East Lyme
4. Big Y, Tolland

See defendant's Exhibit A, p. 40.

From these supermarkets' rental activity, Dondiego determined a market rent of \$21/SF plus a contract rent increase of 2% per annum, for a 20-year triple net lease. See defendant's Exhibit A, p. 40. However, Dondiego settled on a rental price of \$20.55/SF, which is the same amount as the base rent listed on the subject's 2007 report to the assessor. Dondiego arrived at a potential gross revenue of \$1,442,066, including a rent overage of \$100,000 and \$104,100 in expense reimbursements. See defendant's Exhibit A, p. 42. Taking a 3% vacancy and collection loss, Dondiego arrived at an effective gross revenue of \$1,398,804. Deducting operating expenses of \$107,113, Dondiego concluded that the subject's NOI, as of October 1, 2007, was \$1,291,692 to which he applied a tax-included 8.5% capitalization rate resulting in a valuation of \$15,200,000. The 8.5%

capitalization rate was derived by first determining the capitalization rate of 7% and adding a tax factor of 1.49%, rounded to 8.5%. See defendant's Exhibit A, pp. 46-47.

In contrast to Dondiego's 1.49% tax factor in the development of his capitalization rate, Hagearty excluded the tax factor because he concluded that the tenant would pay the taxes.

The tax factor may be handled in two different ways. The property taxes could be paid in the revaluation year as part of the operating expenses. In the alternative, the property tax could be excluded from the operating expenses and added to the tax factor. See *The Appraisal of Real Estate* (12th Ed. 2001) p. 513. A logical reason to exclude the property tax from being listed as an operating expense rather than included as a tax factor in developing the capitalization rate is that what is being sought is the property tax as of a certain date based in part on the capitalization rate. See *id*; see also Hull Junction Holding Corp. v. Princeton Borough, 16 N. J. Tax 68, 108, citing the concurring opinion in Humble Oil & Refining v. Englewood Cliffs Borough, 71 N.J. 401, 403-405, 365 A.2d 929 (1976), for the proposition that "where a landlord pays the property taxes, a tax factor must be included in the capitalization rate, but, where the tenant pays the taxes, no tax factor need be included[.]"

When considering the valuation of income-producing property that derives its income from leases that obligate the tenant to pay the real estate taxes under a triple net lease arrangement, the real property taxes are not part of the owner's operating expenses since these expenses are passed on to the tenant. Consequently, the property taxes, under

these circumstances, should not be reflected as a tax factor in the capitalization rate. See Matter of Mill River Club v. Board of Assessors, 847 N.Y.S.2d 670 (2nd Dept 2007). See also Pine Plaza Assocs., LLC v. Hanover Tp., 16 N.J. Tax 194, 215-16 (1996).

Contrary to Dondiego, Hagearty excluded the tax factor in the computation of his capitalization rate, concluding that, using the Calculation of Overall Rate Band of Investment Method, the total capitalization rate was 8.32%, (rounded to 8.35%). Hagearty concluded that an overall capitalization rate of 8.25% should be used based on various analyses. See plaintiff's Exhibit 6, pp. 36-37.

After analyzing Hagearty's and Dondiego's methodologies in arriving at the subject's rental market, as of October 1, 2007, the difference between both appraisers runs from Hagearty's NOI of \$861,056 (based on a potential gross income of \$17/SF of gross leasable area) divided by an overall capitalization rate (not tax-loaded) of 8.25%, for a final valuation of \$10,435,000 and Dondiego's NOI of \$1,291,692 (based on a potential gross income of \$23.93/SF of gross leasable area) divided by an overall capitalization rate (including a tax factor) of 8.5% for a final valuation of \$15,196,371, rounded to \$15,200,000.

The process of valuation in a property tax appeal is "at best . . . a matter of approximation." Pilot's Point Marina, Inc. v. Westbrook, 119 Conn. App. 604.

Recognizing that in determining the fair market value of the property, the court must consider "*both* [1] net rent for comparable properties and [2] the net rent derived from any existing leases on the property" and further recognizing that "if the property is devoted to

the use for which it is best adapted and is in a condition to produce or is producing its maximum income, the actual rental is a very important element in ascertaining its value.” Id., 603-604. A finding of a market rent for the subject at \$20/SF of gross leasable area expresses these parameters.

Taking the market rent of \$20/SF with a gross leasable area of 60,250 SF for the subject property, the potential gross income is \$1,205,000. Deducting a 3% vacancy/collection loss of \$36,150 results in an effective gross income of \$1,168,850. Deducting further the net operating expense of \$107,000 leaves NOI of \$1,061,850. Dividing NOI of \$1,061,850 by a capitalization rate of 8.35%, Hagearty’s overall capitalization rate (not tax-loaded), results in a finding of value of \$12,716,766. Since the assessor’s valuation of the Lake Avenue property, as of October 1, 2007, was \$13,444,900, this amounts to an overvaluation of \$728,134.

Accordingly, the fair market value of the Lake Avenue property, as of October 1, 2007, is reduced from \$13,444,900 to \$12,716,766.

As discussed above, for both the Newtown Road and Lake Avenue properties, judgment may enter in favor of the plaintiff, without costs to either party.

Arnold W. Aronson
Judge Trial Referee