SUPREME COURT

OF THE

STATE OF CONNECTICUT

S.C. 19750

WALGREEN EASTERN COMPANY, INC.

V.

TOWN OF WEST HARTFORD

BRIEF OF *AMICUS CURIAE* CONNECTICUT CONFERENCE OF MUNICIPALITIES

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II. **Whether Section 12-63b(b) is properly interpreted to require that a municipal assessor consider actual contract rents in the assessment of rental income property.**

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STATEMENT OF INTEREST OF *AMICUS CURIAE*[1]

Established in 1966, the Connecticut Conference of Municipalities ("CCM") is the largest nonpartisan organization of municipal leaders in the State. It currently has 163 member towns, meaning its membership represents almost every town or city in the State. One of its many purposes is to provide advocacy for member towns on issues of general concern and those affecting taxpayers, in particular.

CCM has a compelling interest in the outcome of this appeal because Chapter 203 of the Connecticut general statutes governing property tax assessments, and Section 12-63b in particular, must be properly applied by each and every municipal assessor in the state in arriving at the fair market value of applicable rental income property on a town's grand list. Proper application of Connecticut's tax statutes is not only important for fair and equitable assessments, but also, to ensure that each municipality captures all possible property tax revenue.

In this appeal, CCM advocates for approval of the use by municipal assessors of contract rents as a tool in arriving at the fair market value of income-producing properties, especially where, as here, the contract rents fairly reflect the highest and best use and intrinsic market value of the property.

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[1] Pursuant to Practice Book § 67-7, CCM represents that this brief was written entirely by its counsel. No party to the appeal wrote the brief in whole or in part, nor contributed any costs for the preparation of this brief.

NATURE OF THE PROCEEDINGS

CCM agrees with and adopts the Nature of the Proceedings set forth in the Defendant's brief. See Defendant's Brief at pp. 1-7.

STATEMENT OF FACTS

Connecticut towns rely heavily on property tax revenue to generate the funds necessary for proper and in many instances, state-mandated, municipal operations. A 2015 study conducted for the Connecticut Tax Study Panel reflects that, on average, nearly 74% of Connecticut town revenues are generated by property taxes.[2]

Unique to this appeal, and an issue that has not yet been decided by this Court, is the proper municipal valuation of rental properties that are improved with leased retail drug store uses. There are three major retail drug store chains in Connecticut. According to reports from these drug store chains, there are 92 Walgreens, 174 CVS and 78 Rite Aid drug stores located among Connecticut's 169 municipalities.[3] As the trial court found based upon expert testimony, there is an industry market for properties that meet the requirements of retail drug store tenants. These properties have specific attributes, such as a location on a corner lot at a signalized intersection boasting high traffic counts. (Trial Court's Memorandum of Decision ("MOD") at 7-9). Neighboring complimentary commercial uses to the property in question, such as department stores, banks, restaurants and coffee shops are also attractive to this submarket. Having a stand-alone building on the property

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[2] Overview of Property Taxes in Connecticut, Matthew E. Bell, October 27, 2015 available at https://www.cga.ct.gov/fin/taskforce.asp?TF=20140929_State Tax Panel (last visited February 7, 2017).

[3] See http://www.cvs.com/store-locator/cvs-pharmacy-locations/Connecticut; http://news.walgreens.com/fact-sheets/store-count-by-state.htm; https://locations.riteaid.com/locations/ct.html (last visited March 11, 2017).

that may be "built-to-suit" also is important.[4] This retail drug store submarket is not unique to Connecticut, but rather, is nationwide. Properties in the right location attract these retail drug store chains and command higher rents on triple net lease terms and at lower cap rates than other commercial properties not similarly situated. These characteristics have created a separate submarket for these properties that are touted as prime investment opportunities.[5]

ARGUMENT

Plaintiff urges this Court to effectively overrule the case of First Bethel Associates v. Town of Bethel, 231 Conn. 731 (1995) and command municipal assessors to ignore the mandates of Conn. Gen. Stat. § 12-63b(b) to the extent that they require consideration of contract rents in determining the fair market value of rental properties. Plaintiff also urges this Court to disapprove of recognizing the existing, specific drug store retail use as the highest and best property use for valuation purposes. Plaintiff advocates instead for the use of a much broader defined market, the effect of which could deflate the necessary market rent assessment analysis. As set forth below, if municipal assessors cannot consider specific markets for unique properties or the contract rents they garner in assessing the intrinsic value of a commercial rental property, it will have broad implications for current municipal property tax assessments throughout the state and could negatively affect the ability of municipalities to generate their full potential in property tax revenue.

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[4] See http://www.deerfieldteam.com/investors/whywalgreens.php; http://www.deerfieldteam.com/investors/listings.php; https://www.crexi.com/properties?term=CVS; http://www.loopnet.com/CVS-For-Sale/; http://www.loopnet.com/Walgreens-For-Sale/6/.

[5] See http://westwoodnetlease.com/blog/if-you-want-to-buy-an-nnn-property-consider-purchasing-a-drugstore/; http://nreionline.com/retail/walgreens-rite-aid-merger-will-significantly-impact-net-lease-sector.

I. WHERE A SEPARATE MARKET FOR AN OPTIMUM RETAIL USE EXISTS, IT IS NOT IMPROPERLY RESTRICTIVE TO IDENTIFY THAT USE AS A PROPERTY'S HIGHEST AND BEST USE

During a statutory revaluation, each municipal assessor is charged with the responsibility of determining "the present true and actual value of all real property" on the town's grand list. Conn. Gen. Stat. § 12-62(5). This determination must commence with ascertaining the highest and best use of the property in question. United Techs. Corp. v. Town of E. Windsor, 262 Conn. 11, 25–26 (2002). As this Court has stated:

> A property's highest and best use is commonly defined as "the use that will most likely produce the highest market value, greatest financial return, or the most profit from the use of a particular piece of real estate." The highest and best use determination is inextricably intertwined with the marketplace because "fair market value" is defined as "the price that a willing buyer would pay a willing seller based on the highest and best possible use of the land assuming, of course, that a market exists for such optimum use."

(Internal citations omitted) Id. at 25. By definition, the analysis of highest and best use must take into account the profitability and financial return expected from a particular rental property given that specific use. The appropriate way to come to a conclusion regarding the highest and best use of rental property must include an analysis of the possible uses, the market for each use and the anticipated rent generated by each.

Plaintiff insists that assigning a highest and best use as a retail drug store instead of a more generic retail/commercial use is improperly restrictive and focuses on the "user" rather than the "use." Not so. A retail drug store is a distinct use, just as a retail grocery store is a use that is distinct from a retail department store. While they all may include a retail component, each has their own market of comparable sales. An assessor would be hard pressed to substantiate valuing a property with one of these types of uses based upon market sales of properties boasting the other.

Moreover, recognizing that a particular submarket represents the highest and best use of a property is only a starting point in the valuation process. It does not detract from

all of the analyses that still must take place under Section 12-63b for a specific rental property. Indeed, it enhances it by better demarcating the comparable sales and market rents that should apply. The National Appraisal Institute[6] describes this process as follows:

> Appraisers must consider all relevant transactions that have occurred in the market area and then determine which of those transactions should be used in the sales comparison analysis to arrive at a credible value opinion for the subject property. The best comps are those that are most similar to the subject property in terms of location, size, condition and other features that buyers and sellers believe make a difference to price. After selecting the best comps, the appraiser adjusts for material differences between each comp and the subject property. The appraiser must analyze each comp to ascertain what adjustments are needed.[7]

Consequently, the fear that recognizing a retail drug store submarket as a highest and best use would necessarily result in a Walgreen's located in West Hartford being valued equal to one located in the Gobi Desert is unrealistic.

If there should be any trepidation in selecting a highest and best use vis-a vis commercial rental properties, it should be in adopting a position that requires that an appraiser assign a generic label to a retail drug store use, or any use for that matter, that has a more well-defined and discrete market. To adopt this view runs the risk of improperly diluting those peculiar indicators of value that would more accurately reflect actual value if comparing the property's use to a more particular market. In other words, the more general the market of comparables that is used, the less reflective the ultimate conclusion may be as to the highest and best possible use and fair market value of the real estate in question.

Where, as is the case here, a particular property has all of the characteristics that a retail drug store submarket finds attractive, so much so that it can entice a specific type of tenant into a triple net, long-term lease at premium rents, why would it be appropriate to

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[6] Courts have consistently relied on the Appraisal Institute for guidance in matters of real estate appraisal. See, e.g., First Bethel, 231 Conn. at 739.

[7] See http://www.appraisalinstitute.org/assets/1/7/guide-note-11.pdf

dilute the property's true fair market value by comparing it to a less-than-highest and less-than-best general retail or commercial use? Alternatively, as a general premise, the inability to look to a specific market in valuing properties could also have the effect of inflating the fair market value for those distinct uses that, while still the highest and best use for a given property, may not be as profitable when compared to the averages of a generic retail market. In either scenerio, the "present true and actual value" for the property is not properly captured. Conn. Gen. Stat. § 12-63b.

Consistent with the law on valuation, if there exists a specific market for a particular use, that market should be favored over a general class of uses in circumscribing the parameters used to determine its highest and best use. Only then can the "highest market value, greatest financial return, or the most profit" be accurately ascertained. United Techs., 262 Conn. at 25.

II. CONN. GEN. STAT. § 12-63b(b) PROPERLY ALLOWS AN ASSESSOR TO CONSIDER CONTRACT RENT AT THE TIME OF THE ASSESSMENT

Conn Gen. Stat. § 12-63b(a) requires, the "capitalization of net income based upon market rent for similar property" as one appraisal method to determine the "present true and actual value" of property "used primarily for the purpose of producing rental income." Id. "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 the analysis, the assessor must include consideration of "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." Conn Gen. Stat. § 12-63b(b). It is this later section of the statute that has come under fire in this appeal.

As noted above, specific to this appeal is the application of Section 12-63b(b) in valuing a retail drug store that is subject to a long-term, triple net lease. Plaintiff argues that the mandate of Section 12-63b(b) and this Court's interpretation of that statute in First

Bethel should be (or has already been) overturned. CCM disagrees for several reasons.

A. The First Bethel Court Properly Interpreted Conn. Gen. Stat. § 12-63b

As the First Bethel Court noted from the outset, "[t]he process of valuation at best is a matter of approximation." 231 Conn. at 738. In arriving at the true and actual value of the property in question, assessor's must consider all factors that affect the value of the property. Uniroyal, Inc. v. Middlebury Bd. of Tax Review, 174 Conn. 380, 390 (1978). Section 12-63b(b) states that one of those factors for consideration must be the contract rent. To ignore Section 12-63b(b)'s provisions would, therefore, render "a portion of the statute mere surplusage." First Bethel, 231 Conn. at 741. The First Bethel Court held that under this statute it is proper to consider both actual and market rents in analyzing the value of rental property.

The First Bethel decision has guided municipal assessors in Connecticut for over twenty years and should not be disturbed as a matter of stare decisis.[8] In addition to being relied upon by municipal assessors, First Bethel's interpretation of Section 12-63b(b) and the principles upon which that interpretation were founded also have been repeatedly affirmed by this Court and other Connecticut courts. In Sheridan v. Town of Killingly, 278 Conn. 252 (2006), this Court acknowledged the correctness of First Bethel in determining that a fact finder, pursuant to Section 12-63b(b) "must consider 'both (1) net rent for comparable properties, and (2) the net rent derived from any existing leases on the

[8] "Stare decisis, although not an end in itself, serves the important function of preserving stability and certainty in the law." Clement v. Clement, 34 Conn. App. 641, 647 n.6 (1994). In order for this Court to accept Plaintiff's invitation to overrule First Bethel, the following criteria must be shown: (1) "the most cogent reasons and inescapable logic require [overruling the prior precedent]"; Id.; (2) the decision in First Bethel was "clearly wrong;" Ferrigno v. Cromwell Dev. Assocs., 44 Conn. App. 439, 443 (1997) aff'd, 244 Conn. 189 (1998); and (3) there is a "clear showing" that the rule has been "harmful." Id. Because First Bethel's interpretation of Section 12-63b(b) was correct, or at the very least, not "clearly wrong," its holding should remain intact.

property.'" Id. at 262 (quoting First Bethel, 231 Conn. at 740). See also Pilot's Point Marina, Inc. v. Town of Westbrook, 119 Conn. App. 600, 603–04 (2010) (citing First Bethel for the same proposition.) Because the First Bethel Court properly interpreted and applied Section 12-63b(b), there is no basis for overturning that decision. More importantly, as set forth below, there are other valid and objective policy reasons for considering actual contract rent when valuing rental properties.

B. Actual Contract Rents Are Properly Considered As One Factor In Arriving At Fair Market Value

Conn. Gen. Stat. § 12-63b(b) and the First Bethel decision recognize that the terms of a lease and the rent called for thereunder necessarily impact the fair market value of the property to the extent that it affects the price a buyer is willing to pay for the property on an open market. To reiterate, the "fair market value is [by definition] the price that a willing buyer [will] pay a willing seller based on the highest and best possible use of the land assuming, of course, that a market exists for such optimum use." United Techs. Corp., 262 Conn. at 25. Much like a property that is burdened with a perpetual easement or some other physical characteristic, such as location, that affects market value, the actual rent contained in a long term lease can also affect fair market value in influencing the price a willing buyer will pay.

This Court also expressly recognized this premise in the case of J.E. Robert Co. v. Signature Properties, LLC, 320 Conn. 91 (2016). Citing to the First Bethel case, the J.E. Robert Court acknowledged that actual contract rent can play a significant role in valuation.

> In First Bethel Associates, the defendant town contended that actual or contract rents should be considered only when they are equivalent to the market rents the property would command. We rejected that argument, explaining that such a rule "would mean that contract rent would factor into the analysis only if it had no effect on the overall valuation...."

Id. at 99–101 (ultimately concluding that, "when market rents and contract rents are equal,

the valuation of the fee simple interest of an owner occupied property will be the same as the valuation of the leased fee interest in the property.") Implicit in that decision is the notion that actual contract rent will always be a factor in the fair market value of a property although the degree of impact may vary.

The case of Uniroyal, Inc. v. Middlebury Bd. of Tax Review, 174 Conn. 380 (1978) is instructive. In Uniroyal, at issue was the trial court's use of contract rent as equivalent to market rents in capitalizing net income. The property owner claimed that the lease was not at market rents, but rather, reflected a financing agreement meant to repay the property owner for construction of the site. The Uniroyal Court observed,

> Whether the instrument in question is a lease or a different sort of agreement is not determinative (of the question of whether the amount specified in the lease could be properly capitalized to determine the property's value). The basic question is whether the property was producing its maximum income . . . . The principle expressed derived from Somers v. Meriden, 119 Conn. 5, 8, 174 A. 184, 186, in which this court expressed its view that (a)s a general principle, earning or income-producing capacity, as distinguished from actual earnings, is to be regarded as a factor in valuation for taxation purposes, but 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.

(Internal citation omitted). Id. at 388-89. The Uniroyal Court concluded,

> [I]t cannot be said, either in law or logic, that the actual income accruing to Metropolitan under the particular facts of this case is not a significant factor to be considered in determining what a third party would pay to acquire the property in question. Indeed, in determining value, the trier is under a legal compulsion to consider everything that might legitimately affect value.

Id. at 390. Undeniably, the contract rent an income-producing rental property actually commands also may be the best indicator of the property's highest and best use. See Section I above.

The application of Section 12-63b(b) can be just as important in cases where the actual contract rent is below market value. In those instances, as this Court has found,

knowing the difference between the actual contract rents and the market rents may be the only way to capture fair market value when the contract rents are low. See Sheridan v. Town of Killingly, 278 Conn. at 265 (finding it proper when actual contract rents are below market to combine the capitalization of actual net income with comparable sales at market rents to find true overall fair market value).

Cases from other jurisdictions where there is no compliment to Section 12-63b(b) holding that, as a matter of law, to consider contract rents necessarily means impermissibly valuing only the leased fee or other intangibles are shortsighted. They fail to recognize the interplay between contract rents, market rents and their impact on analyzing the highest and best use and true market value of a particular property. Notwithstanding the mandates of Section 12-63b(b), this Court should not otherwise be persuaded by arguments in favor of such a narrow and restrictive assessment practice. To do so would inappropriately eliminate a significant indicator of value – one that may be more reflective of the innate worth of a specific property than general market data could ever reveal.

Moreover, as noted above, Section 12-63b(b)'s command to consider actual contract rent recognizes the fact that no potential purchaser would ignore contract rent in coming to a conclusion as to what a property is worth. For all of these reasons, municipal assessors should not ignore contract rents either.

C. Neither Conn. Gen. Stat. § 12-63b(b) Or The Court Decisions Interpreting It Mandate The Weight To Be Given To Contract Rent In Determining Fair Market Value

While First Bethel and the other cases citing it make clear that the statute requires the consideration of both market and actual contract rent, this is not to say that contract rents will always weigh heavily in any analysis, much less necessarily trump other evidence of market rents in capitalizing net income. It does mean that both contract and market rents must be considered "and the weight given to each depends on the facts of the

particular case." Union Carbide Corp. v. City of Danbury, 1999 WL 956659, at *18 (Conn. Super. Ct. Oct. 7, 1999), aff'd, 257 Conn. 865 (2001). Neither the statute nor First Bethel dictates that actual rents must outweigh market rents or the amount of significance to be given each. To the contrary, the mandate is only that they be considered. Actual contract rents are but one tool in an assessor's tool belt for determining overall fair market value.

Claims that the use of actual market rent will wreak havoc with rental property valuations are premised on the assumption that municipal assessors will improperly base their valuation on the contract rents when they are high and ignore the contract rents when they are low. This supposition fails to acknowledge the expertise and integrity of the state's municipal assessors. "In Connecticut, it is well settled that proper deference must be given to the judgment and experience of assessors." Union Carbide Corp., 1999 WL 956659, at *6. It also fails to recognize the checks and balances afforded by Section 12-63b in mandating that an assessor consider not only the capitalization of net income, but also, comparable sales and cost less depreciation. Thus, actual contract rents are not and cannot be the only factor used to establish the value of rental properties in Connecticut. Suppositions to the contrary constitute unfounded speculation not grounded in the law or municipal assessment practice.

CONCLUSION

For all the foregoing reasons, this Court should reaffirm the First Bethel decision and the interpretation of Conn. Gen. Stat. § 12-63b(b) requiring that contract rent be considered in the valuation of rental properties. Moreover, where a true submarket for rental properties exists, this Court should commend its use in rental property assessments and reject, in favor of a more accurate valuation, the notion that a broader and more generic comparable market is always required to ascertain the true fair market value of rental properties.

Respectfully submitted,

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CERTIFICATION

The undersigned attorney hereby certifies, pursuant to Connecticut Rule of Appellate Procedure § 67-2, that on March 16, 2017:

(1) the electronically submitted brief has been delivered electronically to the last known e-mail address of each counsel of record for whom an e-mail address has been provided; and

(2) the electronically submitted brief and the filed paper brief have been redacted or do not contain any names or other personal identifying information that is prohibited from disclosure by rule, statute, court order or case law; and

(3) a copy of the brief has been sent to each counsel of record and to any trial judge who rendered a decision that is the subject matter of the appeal, in compliance with Section 62-7; and

(4) the brief being filed with the appellate clerk are true copies of the brief and appendix that were submitted electronically; and

(5) the brief complies with all provisions of this rule.

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CERTIFICATE OF SERVICE

Pursuant to Practice Book § 62-7 the undersigned certifies that a copy of the foregoing was mailed this 16th day of March, 2017, to:

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