

**Matter of Lawrence Enter. Partnership v Board of
Assessors of Nassau County**

2010 NY Slip Op 30517(U)

March 3, 2010

Supreme Court, Nassau County

Docket Number: 402534/07

Judge: Thomas A. Adams

Republished from New York State Unified Court
System's E-Courts Service.
Search E-Courts (<http://www.nycourts.gov/ecourts>) for
any additional information on this case.

This opinion is uncorrected and not selected for official
publication.

S

SHORT FORM ORDER

SUPREME COURT - STATE OF NEW YORK

Present:

HON. THOMAS A. ADAMS,
Acting Supreme Court Justice

TRIAL/IAS, PART 33
NASSAU COUNTY

In the Matter of LAWRENCE ENTERPRISE
PARTNERSHIP,

Petitioner(s),

TRIAL DECISION
INDEX NO.: 402534/07

-against-

THE BOARD OF ASSESSORS, THE BOARD OF ASSESSMENT
REVIEW AND THE ASSESSMENT REVIEW COMMISSION OF
NASSAU COUNTY,

Respondent(s).

This is a tax certiorari proceeding pursuant to Article 7 of the Real Property Tax Law (RPTL § 700 et seq.). Petitioner Lawrence Enterprise Partnership leases a commercial property located at 365 Rockaway Turnpike in Lawrence. The tax map identification of the property is section 40, block A, lot 169. The tax years under review are 2003/04 through 2008/09, and the corresponding value dates are January 2, 2003 through January 2, 2007.¹ A hearing was held before the undersigned on November 10, 2009.

The property consists of 21,000 square feet and is improved with a one-story, freestanding McDonald's fast food restaurant built on a concrete slab. The building was constructed in 1982 and consists of 2,805 square feet. It is equipped with a drive-thru facility. The parking lot can accommodate 26 automobiles.

The property is owned by the MacDonald's Corporation. Petitioner is a MacDonald's franchisee and the current operator of the property. The property is subject to a 20-year "operator's lease" that MacDonald's entered into in September 1992 with Peter and CheryLynn Castiglione, the partners of petitioner. The lease provides for "basic rent" of \$113,100 per year or \$40.30 per square foot. In addition, the lease provides for "percentage rent" of 8.5% of monthly gross sales in excess of \$110,882.35. The lease further provides that the tenant will pay all real estate taxes and special and general assessments which may become due during the term of the lease. The lease requires the tenant to provide "all risk" property and comprehensive general liability insurance and to pay all charges for gas, electricity, water, or other utilities. Finally, the tenant is required to keep the premises in good

¹January 2003 was the valuation date for tax year 2003/04 and 2004/05.

repair, including ordinary, extraordinary, or structural repair of the premises.² Thus, as both appraisers recognized, the operator's lease is a "triple net lease" whereby the tenant is responsible for real estate taxes, insurance, and maintenance (See *Mill River Club v Bd of Assessors*, 48 AD3d 169 [2d Dept 2007]).

From January to April 2009, the restaurant was totally renovated by petitioner at a cost of \$1.5 million.³ Petitioner's annual gross sales were \$1,937,911 for 2004, \$1,876,646 for 2005, \$1,837,331 for 2006, and \$1,812,785 in 2007.⁴

Despite the availability of data for gross sales and the actual rent paid to MacDonald's, petitioner's appraiser elected to estimate fair market rent.⁵ In order to determine fair market rent for tax year 2003/04, petitioner's appraiser analyzed the leases on six comparable commercial properties, including a diner, an "American Burger," a Kentucky Fried Chicken, two Dunkin Doughnuts, and a MacDonald's restaurant.

Similar to the operator's lease covering the subject premises, the leases of the comparable properties required the tenant to pay all real estate taxes. Nevertheless, petitioner's appraiser converted the leases to "semi-net" leases where the landlord is responsible for base year real estate taxes. Thus, petitioner's appraiser applied a "terms adjustment," increasing the rents per square foot of the comparables, apparently by an amount corresponding only to the increase in taxes over the base year.⁶

Additionally, the appraiser applied a "time adjustment" to allow for general price increases over time, including changes in the price of rent. Thus, for the lease executed before January 2003, rent was increased at the rate of 3% per year, and rents were decreased at the rate of 3% per year for leases executed after the valuation date.

Petitioner's "size adjustment" reflected the assumption of "economy of scale," that is larger buildings will lease for a lower rent per square foot than will smaller properties. Since comparable # 1, the diner, was 1,100 square feet larger than the subject property, its rent was adjusted upwards.

²Respondent's ex. B.

³Transcript at 12.

⁴Respondent's ex. C at 4. Gross sales were not reported for 2003 or 2008.

⁵See petitioner's ex. 1, transmittal letter from Richard J. DiGeronimo

⁶Petitioner's ex. 1 at 33. Petitioner's appraiser adjusted the rents by only the amount of the tax increases because of "the tax appeal issues." Thus, he appears to have been concerned that adding the full real estate taxes to rental income would itself cause an increase in the value of the property. Nevertheless, a "distortion of value" is caused not by adding real estate taxes but rather by *deducting* real estate taxes from the rental income generated by the property (See *Senpike Mall Co. v Assessor*, 136 AD2d 19, 22 [4th Dept 1988]).

Conversely, comparable # 4, one of the Dunkin Donuts, was 900 square feet smaller than the subject property and received a downward adjustment.

Petitioner's appraiser applied an adjustment for variations in land to building ratio to reflect the advantage of land area for improvements or parking facilities. The rents of comparables with land-to-building ratios greater than the subject were adjusted downwards by 15%, while the rent of the comparable with a lower land-to-building ratio was increased by 5%.

The rent of all six comparables was reduced by a 5% "condition adjustment" to reflect their superior condition, as compared to the subject property. The rents of the diner, the American Burger, and one of the Dunkin Donuts were adjusted upwards by a "tenancy adjustment" to reflect a higher risk borne by the tenant in operating the premises.⁷

Rockaway Turnpike is a busy thoroughfare, with three lanes of traffic in each direction.⁸ The subject property is located at the corner of Rockaway Turnpike and Bay Boulevard, which petitioner's appraiser considered to be a "desirable retail location." Four of the comparables received a "location adjustment" of either 5 or 10%, because petitioner's appraiser considered these properties to be situated on "inferior retail corridors or non-corner locations."⁹

After all of the adjustments, petitioner's analysis showed a low rent of \$39.20 and a high rent of \$53.08 per square foot. Petitioner's appraiser estimated fair market rent for tax year 2003/04 to be \$42.50 per square foot. This figure was above the median and slightly below the average of the adjusted rents. By applying the area of the building to the estimated rent per square foot, petitioner's appraiser arrived at an indicated annual market rent (or "potential gross income") of \$119,213 for tax year 2003/04.

Petitioner's appraiser used the same estimate for potential gross income for tax year 2004/05 as for 2003/04, apparently because both tax years have the same valuation date. For tax years 2005/06 and 2006/07, petitioner's appraiser estimated potential gross income of \$126,225, an increase of approximately 5.9%. For tax year 2007/2008, petitioner's appraiser estimated potential gross income

⁷While the diner has been in operation only since 1994, the American Burger appears to have been in business since 1965. While the Dunkin Donuts premises was formerly used as a delicatessen, a retail business has been conducted at the location since 1979 (Petitioner's ex. 1 at 31). Why these three businesses were considered a higher risk than the Kentucky Fried Chicken or the other Dunkin Donuts was not fully explained.

⁸See petitioner's ex. 1 at A3.

⁹Petitioner's ex. 1 at 34. Comparable # 1 was located on N. Broadway in Hicksville, comparable # 2 was located on Old Country Road in Hicksville, comparable # 4 was located on Hempstead Turnpike in East Meadow, and comparable # 5 was located on Jericho Turnpike in Syosset. It is not clear why a location adjustment was necessary because the photographs of these properties suggest that they are also located on busy commercial streets (Petitioner's ex. 1 at A6-A8).

of \$129,030, an increase of 2.2%. For tax year 2008/09, the appraiser estimated potential gross income to be the same as in tax year 2006/07.¹⁰ Petitioner's appraiser considered these potential gross income figures to be consistent with "shopping center" data contained in a research publication prepared by a real estate trade association.¹¹ After deducting a vacancy and collection allowance based upon a stipulated 5% rate, petitioner's appraiser arrived at an "effective gross income" for each tax year.¹²

Petitioner's appraiser estimated the operating expenses attributable to the property based upon "market indices" and an analysis of the expenses of three comparable buildings. Management expense was estimated at 5% of effective gross income.¹³ Legal and professional fee expense was estimated to be \$1.00 per square foot, held constant for 2004/05, and then increased at a rate of 3% per year. A reserve for replacement was estimated at .25 per square foot, \$701 for tax year 2003/04, and increased at a rate of 3% per year.

Although petitioner's appraiser assumed that base year real estate taxes were paid by the landlord, real estate taxes were not considered an operating expense. However, petitioner's appraiser deducted insurance cost as a expense even though insurance is also payable by the tenant under a triple net lease. Insurance cost was estimated at \$1.00 per square foot for 2003/04 and increased at a rate of 3% per year. Although maintenance expense is similarly payable by the tenant under a triple net lease, petitioner's appraiser also deducted maintenance cost as an expense. Maintenance cost was estimated at .50 per square foot for 2003/04 and increased at an annual rate of 3% per year.

After deducting total operating expenses, petitioner's appraiser arrived at a "net operating income" for each tax year.¹⁴ The net operating income for tax years 2003/04 and 2004/05 was \$99,876. In petitioner's analysis, net operating income increased to a high of \$108,021 for tax year 2007/08 and decreased to \$105,236 for the final tax year. Petitioner's appraiser noted that the business was operating at a "very low profit margin," which is typical of fast food restaurants.¹⁵ Petitioner's appraiser divided the net operating income by a derived capitalization rate to arrive at an "indicated value" for each year. Petitioner's indicated value for tax years 2003/04 and 2004/05 was \$660,000. In petitioner's analysis, the indicated value reached a high of \$730,000 for tax year 2007/08 and decreased to \$720,000 for tax year 2008/09. Applying stipulated equalization rates to these indicated values, petitioner's appraiser found that the property was over-assessed in each tax year.

Respondent's appraiser similarly estimated fair market rent based upon an analysis of the leases

¹⁰Petitioner's ex. 1 at 42.

¹¹Petitioner's ex. 1 at 34.

¹²Petitioner's ex. 1 at 42.

¹³Petitioner's ex. 1 at 35, 40. As petitioner's appraiser recognized, the proper manner of accounting for real estate tax expense is in the capitalization rate (See *Senpikie Mall Co. v Assessor*, 136 AD2d at 22).

¹⁴Petitioner's ex. 1 at 42.

¹⁵Petitioner's ex. 1 at 36.

of nine comparable commercial properties. However, respondent's appraiser assumed a "triple net lease" where the tenant was responsible for "all costs of operating the facility" and the landlord's obligation was limited to "structural reserves/contingencies and real estate management."¹⁶ Thus, an allowance for "real estate taxes," presumably based upon the entire tax burden, was added to the "base rent" per square foot for eight of the comparables.¹⁷ Nevertheless, the court notes that the lease for respondent's comparable # 6 required the tenant to pay only "real estate tax increases," and no allowance for real estate taxes was added to the base rent for this comparable.

Respondent's appraiser estimated fair market rent of \$55.00 per square foot for tax year 2006/07. This figure represented the mean adjusted rent, rounded down to a whole dollar. Since January 2, 2005 was the midpoint between the valuation dates for the disputed tax years, respondent's appraiser chose it as the "base date." Respondent's appraiser reduced the rents per square foot slightly for the tax years prior to the base year, kept the rent per square foot constant for tax year 2007/08, and reduced the rent slightly for tax year 2008/09.¹⁸

Respondent's comparable leases covered a variety of restaurants, including two Dunkin Donuts, a Kentucky Fried Chicken, a Friendly's, and International House of Pancakes. Four of respondent's comparables also appear in petitioner's analysis. However, respondent's comparables also included a Houlihan's and the Viceroy of India restaurant, which appear to be more "upscale" establishments.¹⁹

Respondent's appraiser adjusted the rents per square foot for "market conditions" at a rate of 3% per year.²⁰ While respondent's base date was January 2, 2005, respondent's adjustment for market conditions was otherwise similar to petitioner's time adjustment. Respondent's appraiser applied a "location adjustment" of 5 or 10% which was based upon visibility and accessibility of the property, demographic composition of the neighboring community, and type and quality of the surrounding commercial development. Respondent's appraiser also applied a "facilities adjustment" of 5%, 10%, or 20% to several of the comparables. This adjustment was based primarily upon the existence of a "drive thru" and the "age and finish of the structure" and is somewhat analogous to petitioner's adjustment for the condition of the premises. Lastly, respondent's appraiser applied a "parking adjustment" of 5 or 10%, which was based on the ratio of parking spaces to the size of the restaurant. This adjustment was similar to petitioner's adjustment for land-to-building ratio.

Applying the rent per square foot to the total leased area and deducting a vacancy allowance at the stipulated rate, respondent's appraiser arrived at an effective gross income for each tax year.

¹⁶Respondent's ex. C at 20.

¹⁷Respondent's ex. C at 23. See also lease abstracts at 30-38.

¹⁸Respondent's ex. C at 20.

¹⁹Respondent's ex. C at 23.

²⁰Respondent's ex. C at 21.

Respondent's appraiser estimated effective gross income to be \$141,232 for tax years 2003/04 and 2004/05.²¹

Based upon an analysis of the expenses of comparable buildings, respondent's appraiser estimated management expense at 4.5% of effective gross income, just slightly lower than petitioner's estimate. Respondent's appraiser estimated the reserve for replacement at .25 per square foot, the same estimate as petitioner's appraiser for 2004/05, and then increased the reserve to a maximum of \$1,403 for the last tax year.²² After deducting operating expenses from effective gross income, respondent's appraiser arrived at a net operating income for each tax year. Respondent's net operating income was \$134,175 for tax year 2003/04.

Applying a derived capitalization rate to the net operating income, respondent's appraiser calculated an indicated or "appraised" value for each tax year. According to respondent's analysis, the indicated value was \$947,000 for tax year 2003/04 and 2004/05 and rose to \$1,073,000 for tax year 2008/09. Applying the stipulated equalization rates to these indicated values, respondent's appraiser concluded that the property was not over-assessed in any tax year.²³

A real property tax assessment may be reviewed upon the grounds that the assessment is excessive, unequal or unlawful, or that the property has been misclassified (RPTL § 706). A tax review proceeding "is in the nature of a trial *de novo* to decide whether the total assessment of the property is correct and, if it is not, to correct it" (*Pleasant Valley v Board of Real Property Services*, 253 AD2d 8, 14 [2d Dept 2009]). The court's "concern is with the assessment imposed and not the manner in which the assessment was determined" (Id).

A property valuation by a tax assessor is presumptively valid (*Century Realty, Inc. v Commissioner*, 15 AD3d 652 [2d Dept 2005]). In challenging an assessment, petitioner has a threshold burden of coming forward with substantial evidence to rebut the presumption of validity (Id at 653). The substantial evidence standard is a "minimal standard" that merely requires the petitioner to demonstrate the existence of a "valid and credible dispute" regarding valuation, through the presentation of documentary and testimonial evidence that is based on "sound theory and objective data" (Id). "During this threshold inquiry, the ultimate strength or credibility of the petitioner's arguments is not at issue, nor is the weight to be given either party's evidence" (Id).

"Once a petitioner meets its burden of overcoming the presumption of validity, it is necessary for a court to weigh the entire record of evidence offered by both parties to determine whether the petitioner proved by a preponderance of the evidence that the property was overvalued" (Id at 654). "In reaching its determination, the court should consider the relative merits of the appraisal methods used by the parties' experts and make adjustments to the appraisals, where appropriate, to more accurately reflect the market value of the subject property...." (Id).

²¹Respondent's ex. C at 29.

²²Respondent's ex. C at 26, 29.

²³Respondent's ex. C at 2.

The petitioner may meet its minimal burden of overcoming the presumption of validity by submitting an appraisal utilizing an accepted method of valuation (*Rosewood Property Co. v Bd of Assessment Review*, 309 AD2d 1163 [4th Dept 2003]). Petitioner met its threshold burden as to each tax year because income capitalization is an accepted method of valuation. Thus, the court will proceed to determine based on the entire record whether the property was overvalued for each tax year and, if so, what are the correct assessments.

Income capitalization is ordinarily the “preferred mode” for valuing income producing property (*Merrick v Bd of Assessors*, 45 NY2d 538, 542 [1978]). While “realized income will often ...be the surest indicator of full value, when fair market rents exceed rental income, the latter may...defer to more precise means of fixing a base on which to compute capitalization” (Id at 543). For example, where a landlord and tenant are business affiliates, or the property is owner-occupied, or there is collusion between landlord and tenant, the rent arrangement will be of little guidance to sound appraisal (Id). Thus, when the actual rent does not represent fair market value, the comparable lease income method may be used as “a component of the income capitalization approach to real property valuation” (*Saratoga Harness Racing, Inc. v Williams*, 91 NY2d 639, 644 [1998]).

In the present case, both appraisers utilized the income approach to valuing the property. The court recognizes that MacDonald’s may indeed have superior bargaining power in the relationship with its franchisee. However, there is no evidence of collusion between petitioner and MacDonald’s, or any other evidence suggesting that the rent reserved in the operator’s lease is not equivalent to fair market rent. Thus, the court concludes that both appraisers erred in utilizing the comparable lease method rather than capitalizing actual rent.

The court further concludes petitioner’s appraiser erred in converting the lease from a triple net to a semi-net lease in his analysis. “The value of real estate for assessment purposes is not affected by any agreement between the owner and the tenant. The income approach to valuation is based upon an estimate of the economic or market rent for the leased premises. The economic or market rent takes into account all of the fair and reasonable payments, judged by rents in the marketplace, that a tenant makes for the use of the premises. If the tenant pays all or part of the taxes, [or insurance or maintenance] that additional payment may be considered as part of economic rent” (*Senpikie Mall Co. v Assessor*, 136 AD2d 19, 23 [4th Dept 1988]). By shifting the burden of base year real estate taxes to the landlord, and changing insurance and maintenance from income to expense items, petitioner’s appraiser understated the economic value of the property.

Accordingly, the court will calculate the value of the property for each tax year by the following method. The court will begin by calculating the economic rent for each year by adding basic rent, percentage rent, actual real estate taxes paid, maintenance charges, and insurance. Although the gross sales figures do not coincide precisely with the tax years, the court will use the 2004 gross sales to estimate percentage rent for the 2004/05 tax year and proceed in similar fashion for subsequent years.²⁴ Since the tax roll becomes final on April 1, there is substantial overlap between the calendar year and the tax year and relatively little probability that the income for the tax year will be distorted. As noted

²⁴Since percentage rent is payable on monthly gross sales in excess of \$110,882, the court has estimated percentage rent for the taxable year as 8.5% of gross sales in excess of \$1,330,584.

above, gross sales for 2003 and 2008 were not reported. However, the court will use the 2004 gross sales to estimate percentage rent for the 2003/04 tax year because both tax years have the same valuation date. The court will use the 2007 gross sales to estimate percentage rent for 2008/09 because the burden to show a decrease in gross sales is on the petitioner. The court will adopt the estimates as to insurance and maintenance charges offered by petitioner because respondent offered no evidence as to these items.

Although the actual real estate charges paid were not offered into evidence, the court has obtained this information from the website of the Nassau County Assessors Office.²⁵ For tax year 2004/05, the combined school and general taxes were \$42,859. Although data was not available for tax year 2003/04, the court will use the 2004/05 taxes for that year because both years have the same valuation date. For tax year 2005/06, the combined taxes were \$42,088. For tax year 2006/07, the combined taxes were \$42,227. For tax year 2007/08, the combined taxes were \$38,043. For tax year 2008/09, the combined taxes were \$38,266.

From the economic rent for each tax year, the court will deduct a vacancy allowance at the stipulated 5% rate. The court will adopt petitioner's management expense rate of 5% of effective gross income as being more in keeping with the requirements of managing a franchise. The appraisers agreed as to the reserve for replacement in the first year, although, ironically, respondent's appraiser increased the reserve at a more rapid rate. Nonetheless, in view of the evidence that the cost of renovation was \$1.5 million, the court deems the appraisers' allowances for the reserve for replacement to be inadequate. If the cost of renovation were to be amortized over the 20 year term of the operator's lease, the annual expense for renovation would be \$75,000. The court will adopt this figure as a reasonable estimate as to the reserve for replacement. In order to arrive at indicated values, the court will divide the resulting net income figures by the stipulated capitalization rates.

For tax year 2003-04, basic rent was \$113,100. Percentage rent was \$51,622. Real estate taxes were \$42,859. Maintenance was \$1,403 and insurance was \$2,805. Thus, total economic rent was \$211,789. Effective gross income, after the vacancy allowance, was \$201,199. Management expense was \$10,059. Net income after management expense and reserve for replacement is \$116,139. The stipulated capitalization rate for 2003/04 is .1467.²⁶ Thus, the indicated value for 2003/04 is \$791,676. Applying the equalization rate, the indicated assessment is \$7,402. Since the actual assessment was \$7,651, there should be a reduction of \$249 for tax year 2003/04.

For tax year 2004/05, the indicated assessment is also \$7,402. However, the actual assessment was \$7,419. Thus, there should be a reduction of \$17 for tax year 2004/05.

For tax year 2005-06, basic rent was \$113,100. Percentage rent was \$46,415. Real estate taxes were \$42,088. Maintenance was \$1,445 and insurance was \$2,889. Thus, total economic rent was \$205,937. Effective gross income, after the vacancy allowance, was \$195,640. Management expense was \$9,782. Net income after management expense and reserve for replacement is \$110,858. The

²⁵<http://www.nassaucountyny.gov/mynassauproperty/main.jsp>

²⁶ Transcript at 8.

stipulated capitalization rate for 2005/06 is .1429.²⁷ Thus, the indicated value for 2005/06 is \$775,773. Applying the equalization rate, the indicated assessment is \$7,253. Since the actual assessment was \$7,419, there should be a reduction of \$166 for tax year 2005/06.


For tax year 2006-07, basic rent was \$113,100. Percentage rent was \$43,073. Real estate taxes were \$42,227. Maintenance was \$1,488 and insurance was \$2,976. Thus, total economic rent was \$202,864. Effective gross income, after the vacancy allowance, was \$192,720. Management expense was \$9,636. Net income after management expense and reserve for replacement is \$108,084. The stipulated capitalization rate for 2006/07 is .1417.²⁸ Thus, the indicated value for 2006/07 is \$762,766. Applying the equalization rate, the indicated assessment is \$7,131. Since the actual assessment was \$9,257, there should be a reduction of \$2,126 for tax year 2006/07.

For tax year 2007-08, basic rent was \$113,100. Percentage rent was \$40,987. Real estate taxes were \$38,043. Maintenance was \$1,533 and insurance was \$3,065. Thus, total economic rent was \$196,728. Effective gross income, after the vacancy allowance, was \$186,891. Management expense was \$9,344. Net income after management expense and reserve for replacement is \$102,547. The stipulated capitalization rate for 2007/08 is .1383.²⁹ Thus, the indicated value for 2007/08 is \$741,482. Applying the equalization rate, the indicated assessment is \$7,155. Since the actual assessment was \$9,643, there should be a reduction of \$2,488 for tax year 2007/08.

For tax year 2008-09, basic rent was \$113,100. Percentage rent was \$40,987. Real estate taxes were \$38,266. Maintenance was \$1,579 and insurance was \$3,157. Thus, total economic rent was \$197,089. Effective gross income, after the vacancy allowance, was \$187,234. Management expense was \$9,361. Net income after management expense and reserve for replacement is \$102,873. The stipulated capitalization rate for 2008/09 is .1373.³⁰ Thus, the indicated value for 2008/09 is \$749,257. Applying the equalization rate, the indicated assessment is \$7,192. Since the actual assessment was \$10,255, there should be a reduction of \$3,063 for tax year 2008/09.

This shall constitute the decision, order, and judgment of the court.

DATED MAR 03 2010


A.J.S.C.

ENTERED

MAR 09 2010

**NASSAU COUNTY
COUNTY CLERK'S OFFICE**

²⁷Transcript at 8.
²⁸Transcript at 8.
²⁹Transcript at 8.
³⁰Transcript at 8.