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Implementing new property revaluations in Connecticut

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By Miles Andrews

October 1st is approaching and several towns in Connecticut will begin implementing new property revaluations. Town wide revaluations frequently are accompanied by appeals of individual property assessments, and appraisers who accept assignments for income producing properties should take care to review how Connecticut law treats certain common appraisal concepts. The Connecticut courts have based their decisions for tax appeals in recent years on the requirements of a statute that governs the assessment of income properties; Section 12-63b of the Connecticut Code. The courts have interpreted subsection (b) of the statute in a manner that may come as a surprise to some appraisers. This subsection of the statute states that "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".

Appraisers are required by our code of standards and ethics (USPAP) to clearly identify the property interest appraised. Many appraisers will identify this as the "fee simple" interest in a property where the appraisal is to be used in the course of a tax appeal. This type of property interest is generally defined as including all rights that are ordinarily present in private ownership which are held by the property owner, and the owner's rights are not constrained by the rights conveyed in a lease contract. The interest of the owner in a property that is subject to a lease is termed a "leased fee" interest. The amount of rent received by a property owner may deviate from current market rent levels as market conditions change over time, and where that has happened, appraisers will note that there is a difference between the value of a fee simple interest and the value of an interest that is constrained (or enhanced) by the rights and obligations of a tenant (i.e, the leased fee interest).

A literal reading of the statutory requirement that the "assessor shall consider" the terms of a lease in place on the revaluation date does not seem to contradict the ordinary practice in a fee simple appraisal where a rent roll is examined to see if the leases in place happen to reflect current market rental terms. When an appraiser refers to a rent or price as being "at market", or as reflecting a "market rate", it is commonly accepted that the price level referred to relates to a specific date. This assumption is so fundamental to appraisal theory and to the common practice of market participants that the "specific date" qualifier often goes unspoken. The courts, however, have made it clear that the term "market rent" can have a broader meaning than the standard appraisal usage.

Consider the following quote from the decision by the Connecticut Supreme Court in the matter of First Bethel Associates v. Town of Bethel 231 Conn. 731 (1-10-95). The court recited the normal appraisal meaning of market rent, and then went on to say about 12-63 b (b) that

"...the statute requires that, in determining a property's "market rent", the assessor and, therefore, the court, in determining the fair market value of a property, must consider both (1) net rent for comparable properties, and (2) the net rent derived from any existing leases on the property."

The court's opinion went on to state that assessment valuation must reflect the effect on willing buyers and sellers in arriving at a price where a property is "...subject to leases that do not closely approximate current rentals for similar properties." [The quote is direct, but the emphasis is mine]. The court's decision has the effect of expanding the concept of "market rent" to include any transaction between a willing landlord and tenant because it is an artifact of the market. As used in this manner by the courts, the meaning of "at market" can become decoupled from the valuation date, and it is an odd idea to an appraiser that a rent can be considered to a "market rent" even when the terms are not consistent with rates for similar properties on the date of appraisal.

A "market rent" that is determined in this manner is not necessarily consistent with a rental value that is based solely on recent rents paid at comparable properties, and the use of the term "fee simple" as it is ordinarily defined and used by appraisers, does not comport with the statutory requirement to consider both comparable rents and contract income. The requirement to simultaneously consider rent comparables and contract rent may also be ambiguous with respect to the definition of a leased fee interest because ordinarily, contract and market terms are not viewed as simultaneously defining the terms of rent to be received from a single tenancy. The court's requirement would appear to be most similar to the process of modeling rent over time in a discounted cash flow model, but single year income models have typically been used in appraisals for tax appeals.

Appraisers need to consider that under 12-63b (b) the property interest that is analyzed in the course of a tax appeal may not be what we would normally call a fee simple interest where there is a lease in place that does "...not closely approximate current rentals for other properties". The statute and the First Bethel decision require that such a lease must be considered. "Shall consider" does not mean cite and ignore. The requirement is to accept the effect on value, if any, that a contracted income stream is likely to have where a buyer and seller are normally motivated and informed.

Appraisers have borrowed the terms "fee simple" and "leased fee" from law in order to describe the property rights we appraise, and it should be of interest to appraisers that the statute and case law generally avoid the use of these terms. The first use that I have observed occurs in a decision very recently published by the Honorable Arnold Aronson in the matter of Stop and Shop Supermarket Company v. City of Danbury on July 14, 2010. In Judge Aronson's decision the terms "fee simple" and "leased fee" are cited, but only in the context of describing how an expert witness explained his analysis. Judge Aronson did not use either term to define the property interest for which he found a value.

The USPAP requirement to identify the property interest that we appraise remains, and appraisers need to describe the property interest they are appraising under the strictures of 12-63b (b). An unambiguous direction from case law would be helpful, but this is unlikely to happen where the courts tend to avoid the use of terms that appraisers have defined. The requirement for appraisers to identify the property interest is somewhat problematic because there is not a ready fit between the statute and appraisal theory.

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