COMMONWEALTH OF MASSACHUSETTS

**APPELLATE TAX BOARD**

# BRE/ESA 2005 PORTFOLIO, LLC  v.    BOARD OF ASSESSORS OF

#     THE CITY OF WOBURN

Docket Nos.: F324405

 F327508

 F331417 Promulgated:

 May 22, 2018

 These are appeals under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 59, §§ 64 and 65, from the refusal of the Board of Assessors of the City of Woburn (“appellee” or “assessors”) to abate taxes on certain real estate located in Woburn owned by and assessed to BRE/ESA 2005 Portfolio, LLC (“appellant”), under G.L. c. 59, §§ 11 and 38, for fiscal years 2014, 2015 and 2016 (“fiscal years at issue”).

 Commissioner Rose heard these appeals. Chairman Hammond and Commissioners Scharaffa, Chmielinski and Good joined him in the decisions for the appellee.

These findings of fact and report are made pursuant to a request by the appellant under G.L. c. 58A, § 13 and 831 CMR 1.32.

 *Leonard H. Freiman,* Esq. for the appellant.

 *Anthony M. Ambriano*, Esq., for the appellee.

## FINDINGS OF FACT AND REPORT

On the basis of testimony and exhibits offered into evidence at the hearing of these appeals, the Appellate Tax Board (“Board”) made the following findings of fact.

On January 1, 2013, January 1, 2014, and January 1, 2015, the relevant valuation and assessment dates for each fiscal year at issue, the appellant was the assessed owner of a 1.51-acre parcel of land improved with a commercial hotel located at 831 Main Street in Woburn (“subject property”).

For fiscal year 2014, the assessors valued the subject property at $4,700,900 and assessed a tax thereon, at a rate of $27.41 per $1,000, in the total amount of $128,851.66.  The appellant timely paid the tax due without incurring interest and, in accordance with G.L. c. 59, §  59, timely filed an abatement application on Monday, February 3, 2014. The assessors denied the abatement application on April 10, 2014, and on June 30, 2014, the appellant seasonably filed an appeal under the formal procedure with the Board. On the basis of these facts, the Board found and ruled that it had jurisdiction to hear and decide the appeal for fiscal year 2014.

For fiscal year 2015, the assessors valued the subject property at $5,008,000 and assessed a tax thereon, at a rate of $26.30 per $1,000, in the total amount of $131,710.40.  The appellant timely paid the tax due without incurring interest and, in accordance with G.L. c. 59, § 59, timely filed an abatement application on February 6, 2015.[[1]](#footnote-1) The assessors denied the abatement application on March 26, 2015, and on June 17, 2015, the appellant seasonably filed an appeal under the formal procedure with the Board. On the basis of these facts, the Board found and ruled that it had jurisdiction to hear and decide the appeal for fiscal year 2015.

For fiscal year 2016, the assessors valued the subject property at $5,508,800 and assessed a tax thereon, at a rate of $25.79 per $1,000, in the total amount of $142,071.95.  The appellant timely paid the tax due without incurring interest and, in accordance with G.L. c. 59, § 59, timely filed an abatement application on February 1, 2016. The assessors denied the abatement application on April 21, 2016, and on July 13, 2016, the appellant seasonably filed an appeal under the formal procedure with the Board. On the basis of these facts, the Board found and ruled that it had jurisdiction to hear and decide the appeal for fiscal year 2016.

The subject property has frontage along Main Street in Woburn, also known as Route 38, and is located less than a half mile from Route 128, a major highway. The subject property is also in close proximity to municipal transportation, retail stores, grocery stores, pharmacies, restaurants, churches, and recreational facilities and is therefore considered a good location for a hotel.

The subject property is improved with a 3-floor, 100-room, limited-service hotel, built in 1999 and containing a total area of approximately 44,808 square feet, with a brand name of Extended Stay America (“subject hotel”). An extended-stay hotel is typically defined as a limited-service hotel, which appeals to hotel guests requiring accommodations for 5 nights or longer. The subject property has a fitness room, guest laundry room, a small vending machine area and counter where a “Grab ‘n Go” continental breakfast is served, an outdoor pool, and a courtyard area with grills.

An extended-stay hotel offers larger-than-normal room sizes, with designated living and sleeping areas, kitchenette areas, limited guest services, and little-to-no public areas within the hotel. Close proximity to grocery stores, pharmacies and recreational activities are major considerations for developers of extended-stay hotels. The Extended Stay America hotel chain is considered a mid-price or economy-scale extended-stay hotel brand, with a daily rate between $40 and $90.

The subject property, like all Extended Stay America properties, is owned by a real estate investment trust (“REIT”), in this case, the appellant. The primary issue in these appeals is the appropriate calculation of the operating expenses for the subject property; in particular, the deductibility of certain expenses that were paid by the appellant that the appellee maintained were not properly allocated to the subject property (“REIT expenses”).

The appellant presented its case-in-chief through the testimony of Mitchell Wilson, who is employed by Ad Valorem Tax, Inc., the tax representative for the appellant, and through the testimony and appraisal report of Susan Balogh. Mr. Wilson is a licensed appraiser in the state of Colorado and other states but not in Massachusetts. Ms. Balogh is a licensed appraiser in the state of Massachusetts, and the Board qualified her as an expert in the area of commercial real estate valuation.

Mr. Wilson began his testimony by explaining the appellant’s position that the REIT expenses should be deducted from the subject property’s gross revenue. Mr. Wilson testified that a single REIT owns multiple properties and further, a REIT must maintain a management company that is separate from the entity that holds title to its real estate. Therefore, he testified, the hotel chain would have expenses due to the oversight of multiple properties. These expenses, he testified, would not be allocated to the profit and loss statement of the individual property. Mr. Wilson cited examples that included initial public offering (“IPO”) costs, compensation expenses of the corporate staff, and professional fees. The appellant referred to these expenses as “undistributed operating expenses,” and they include the REIT expenses at issue in these appeals.

Next, Ms. Balogh testified and presented her appraisal report. Ms. Balogh first determined that the highest and best use of the subject property was its continued use as an extended-stay hotel. Ms. Balogh next considered the 3 approaches to value -– cost approach, sales-comparison approach, and income-capitalization approach –- and determined that the income-capitalization approach was the most appropriate for the subject property, because she believed that it was the approach that potential investors would use to value the subject property.

For her income-capitalization method, Ms. Balogh weighed the subject property’s operating history against published industry operating statistics as well as data from 6 properties that she identified as being comparable to the subject property: La Quinta Inns & Suites in Andover; La Quinta Inns & Suites in Somerville; Candlewood Suites in Boston/Braintree; Candlewood Suites in Burlington; Sonesta ES Suites in Burlington; and Sonesta Suites in Andover. Based on her analysis, Ms. Balogh determined that the subject property’s average daily rate (“ADR”) per room of $72.09 from fiscal year 2014 reflected a market rate for a hotel of the subject property’s caliber. Ms. Balogh rounded this figure to reach an ADR of $72.10.

Ms. Balogh next determined a vacancy rate by analyzing occupancy rates for the various hotel groups in the relevant suite market. She arrived at an occupancy rate of 71.6% for fiscal year 2014 and applied it to her ADR to arrive at a revenue-per-available-room of $51.63. Based on the subject hotel’s days of operation during fiscal year 2014, and the rooms occupied, Ms. Balogh arrived at a total annual room revenue of $1,889,616.

Ms. Balogh then added other miscellaneous sources of hotel income, including guest laundry, pet charges, vending machines, cancellation fees, damage charges and additional housekeeping fees. Ms. Balogh’s calculations yielded an operating revenue of $1,910,312 for fiscal year 2014.

Ms. Balogh next determined expenses, which she deducted from total operating revenue. Here, Ms. Balogh deducted “departmental expenses,” which are attributable to a certain profit center. Her departmental expenses were: “rooms expenses” for items like linens, guest room supplies, equipment repair, cleaning supplies, commercial laundry, breakfast, and payroll; “telephone expenses,” for the cost of equipping the rooms with telephone and internet services; and “miscellaneous expenses” for cash and credit management services including chargebacks, discounts and write offs.

Ms. Balogh also determined the “undistributed operating expenses,” the costs borne by the appellant REIT but not attributable to any particular property that it owned. These included the REIT expenses at issue in these appeals, which had been reported to her by Mr. Wilson. Ms. Balogh’s appraisal report indicated that the REIT expenses totaled $500,076.

Ms. Balogh then deducted so called “inn-level expenses,” those attributable to the subject property. In this category, Ms. Balogh deducted both marketing expenses as well as “chain service/marketing” fees.

Next, Ms. Balogh deducted a management fee equal to 4% of total revenue. Finally, Ms. Balogh deducted other expenses, like insurance and reserves for replacement. After deducting all of her expenses, Ms. Balogh arrived at a net operating income of $500,293 for fiscal year 2014.

To derive her capitalization rate, Ms. Balogh developed market extraction, market survey and band-of-investment analyses. Based on these analyses, Ms. Balogh settled on an appropriate overall capitalization rate of 10%, which she then loaded with the appropriate tax rate to derive an adjusted overall capitalization rate of 12.741 for fiscal year 2014. Applying this capitalization rate to the subject property’s net operating income yielded an indicated value of $3,926,638, which Ms. Balogh rounded to $3,925,000 as her conclusion of fair market value for the subject property for fiscal year 2014.

Ms. Balogh’s analyses for the other 2 fiscal years at issue were similar to her analysis for fiscal year 2014.

Ms. Balogh’s income-capitalization analyses for the 3 fiscal years at issue are summarized in the following table:

|  |  |  |  |
| --- | --- | --- | --- |
| **Fiscal year** | **FY 2014** | **FY 2015** | **FY 2016** |
| **Gross revenue** **- ADR** **- occupancy** |  $1,905,264 - ADR = $72.09 - occ. = 71.6% |  $1,909,488- ADR = $80.79- occ. = 63.3% |  $2,098,149- ADR = $86.09- occ. = 65.54% |
| **departmental expenses** | ($ 398,423) | ($ 380,398) | ($ 437,830) |
| **“undistributed operating expenses” including REIT expenses** | ($ 715,741)\*$500,076 of which is REIT expenses | ($ 702,499)\*$394,517 of which is REIT expenses | ($ 758,932)\*$441,110 of which is REIT expenses |
| **management fee** | ($ 76,211) | ($ 76,380) | ($ 83,926) |
| **fixed charges** | ($ 214,596) | ($ 212,084) | ($ 229,863) |
| **net operating income** |  $ 500,293 |  $ 538,127 |  $ 587,598 |
| **overall capitalization rate** | /12.741% | /12.630% | /12.179% |
| **indicated value** |  $3,926,638 |  $4,260,704 |  $4,667,180 |
| **Rounded** |  $3,925,000 |  $4,260,000 |  $4,670,000 |

The appellee presented its case in chief through the testimony and appraisal report of John Connolly, whom the Board qualified as an expert in the area of commercial real estate valuation.

Mr. Connolly agreed that the subject property’s highest and best use was its continued use as a suite hotel. Mr. Connolly also determined that the income-capitalization approach was the most appropriate method for determining the fair market value of the subject property. Mr. Connolly’s total revenue figures for the 3 fiscal years at issue were very similar to Ms. Balogh’s gross revenue figures; in fact, Mr. Connolly’s figures were slightly lower in all 3 fiscal years, as the table below indicates:

**Gross Revenue**

|  |  |  |  |
| --- | --- | --- | --- |
| **Fiscal year** | **FY 2014** | **FY 2015** | **FY 2016** |
| **Ms. Balogh** | $1,905,264 | $1,909,488 | $2,098,149 |
| **Mr. Connolly** | $1,902,693 | $1,806,255 | $2,083,179 |

Moreover, Mr. Connolly’s overall capitalization rates were actually slightly higher than Ms. Balogh’s overall capitalization rates for all 3 fiscal years at issue, as reflected in the table below:

**Capitalization Rate**

|  |  |  |  |
| --- | --- | --- | --- |
| **Fiscal year** | **FY 2014** | **FY 2015** | **FY 2016** |
| **Ms. Balogh** | 12.741% | 12.630% | 12.179% |
| **Mr. Connolly** | 13.5% | 14.1% | 12.8% |

The principal difference between Ms. Balogh’s and Mr. Connolly’s appraisal reports, which resulted in the appellant’s lower fair market value, is the calculation of operating expenses that were deducted from gross revenue. Ms. Balogh included the REIT expenses as operating expenses, but Mr. Connolly did not. The appellee contended that the REIT expenses – including but not limited to IPO costs, compensation expenses of the corporate staff, and professional fees -- were related only to the operation of the appellant but were not related to the net operating income of the subject property.

Mr. Connolly’s income-capitalization method is summarized in the following table:

|  |  |  |  |
| --- | --- | --- | --- |
| **Fiscal year** | **FY 2014** | **FY 2015** | **FY 2016** |
| **Gross revenue** |  $1,902,693 |  $1,806,255 |  $2,083,179 |
| **operating expenses, incl. management, franchise fee, replacement reserves** | ($1,046,481) | ($ 993,440) | ($1,145,748) |
| **net operating income** |  $ 856,212 |  $ 812,815 |  $ 937,430 |
| **overall capitalization rate** | /13.5% | /14.1% | /12.8% |
| **indicated value** |  $6,342,310 |  $5,764,644 |  $7,323,675 |
| **Rounded** |  $6,300,000 |  $5,800,000 |  $7,300,000 |
| **Assessed value** |  $4,700,900 |  $5,008,000 |  $5,508,800 |

Based on the evidence presented, the Board found and ruled that the REIT expenses that Ms. Balogh included in her income-capitalization analysis were not relevant to the valuation of the subject property in these appeals. Ms.  Balogh did not isolate those corporate-level expenses that were related to the operation of the subject property. Expenses such as stock compensation, IPO costs, and public company transition costs have nothing to do with the net operating income of the subject property. Therefore, consideration of these expenses does not aid in determining the earning capacity of the subject property, the fundamental premise for application of the income-capitalization approach.

Without including the contested REIT expenses, Ms. Balogh’s income-capitalization analysis would yield an indicated value that would be higher than the assessed value for all 3 fiscal years at issue, as reflected in the following table:

|  |  |  |  |
| --- | --- | --- | --- |
| **Fiscal year** | **FY 2014** | **FY 2015** | **FY 2016** |
| **Gross revenue** |  $1,905,264 |  $1,909,488 |  $2,098,149 |
| **departmental expenses** | ($ 398,423) | ($ 380,398) | ($ 437,830) |
| **operating expenses not including REIT expenses** | ($ 215,665) | ($ 307,982) | ($ 317,822) |
| **management fee** | ($ 76,211) | ($ 76,380) | ($ 83,926 |
| **fixed charges** | ($ 214,596) | ($ 212,084) | ($ 229,863) |
| **net operating income** |  $1,000,369 |  $ 932,644 |  $1,028,708 |
| **overall capitalization rate** | /12.741% | /12.630% | /12.179% |
| **indicated value** |  $7,851,573 |  $7,384,355 |  $8,446,572 |
| **Assessed value** |  $4,700,900 |  $5,008,000 |  $5,508,800 |

 In addition, the Board found that Ms. Balogh overstated her inn-level expenses by double-counting certain expenses. For example, her franchise fees and chain service/marketing expenses resulted in deductions for the same expenses in 2 different categories.

The Board therefore found that Ms. Balogh’s expenses were overstated, mainly because REIT expenses were not deductible under the income-capitalization approach and also because she incorrectly double-counted some expenses. On these bases, the Board found and ruled that the appellant failed to meet its burden of proving a fair market value for the subject property that was lower than its assessed value for all 3 fiscal years at issue.

 Accordingly, the Board issued decisions for the appellee in these appeals.

**OPINION**

The assessors are required to assess real estate at its fair cash value. G.L. c. 59, § 38. Fair cash value is defined as the price on which a willing seller and a willing buyer in a free and open market will agree if both of them are fully informed and under no compulsion. ***Boston Gas Co. v. Assessors of Boston***, 334 Mass. 549, 566 (1956).

The appellant has the burden of proving that the property has a lower value than that assessed. “‘The burden of proof is upon the petitioner to make out its right as [a] matter of law to [an] abatement of the tax.’” ***Schlaiker v. Assessors of Great Barrington***, 365 Mass. 243, 245 (1974) (quoting ***Judson Freight Forwarding Co. v. Commonwealth***, 242 Mass. 47, 55 (1922)). In appeals before this Board, a taxpayer “may present persuasive evidence of overvaluation either by exposing flaws or errors in the assessors’ method of valuation, or by introducing affirmative evidence of value which undermines the assessors’ valuation.” ***General Electric Co. v. Assessors of Lynn***, 393 Mass. 591, 600 (1984) (quoting***Donlon v. Assessors of Holliston***, 389 Mass. 848, 855 (1983). “[T]he board is entitled to ‘presume that the valuation made by the assessors [is] valid unless the taxpayers . . . prov[e] the contrary.’” ***General Electric Co.***, 393 Mass. at 598 (quoting ***Schlaiker***, 365 Mass. at 245).

Generally, real estate valuation experts, the Massachusetts courts, and this Board rely upon 3 approaches to determine the fair cash value of property: income capitalization, sales comparison, and cost reproduction. ***Correia v. New Bedford Redevelopment Authority,*** 375 Mass. 360, 362 (1978). “The board is not required to adopt any particular method of valuation,” ***Pepsi-Cola Bottling Co. v. Assessors of Boston***, 397 Mass. 447, 449 (1986), but the income-capitalization method “is frequently applied with  respect to income-producing property.” ***Taunton Redevelopment Associates v. Assessors of Taunton,*** 393 Mass. 293, 295 (1984).In the present appeals, the Board agreed with both parties that the income-capitalization approach was the most appropriate method to value the subject property for the fiscal years at issue.

Under the income-capitalization method, it is the earning capacity of property that is the relevant inquiry. “The direct capitalization of income method analyzes the property’s capacity to generate income over a one-year period and converts the capacity into an indication of fair cash value by capitalizing the income at a rate determined to be appropriate for the investment risk involved.” ***Olympia & York State Street Co. v. Assessors of Boston***, 428 Mass. 236, 239 (1998). “It is the net income that a property *should* be earning, not necessarily what it actually earns, that is the figure that should be capitalized.” ***Peterson v. Assessors of Boston***, 62 Mass. App. Ct. 428, 436 (2004) (emphasis in original). Accordingly, the income stream used in the income-capitalization method must reflect the property’s earning capacity or economic rental value. ***Pepsi-Cola Bottling Co.,*** 397 Mass. at 451. Imputing rental income to the subject property based on fair market rentals from comparable properties is evidence of value if, once adjusted, they are indicative of the subject property’s earning capacity. *See* ***Correia v. New Bedford Redevelopment Auth.***, 5 Mass. App. Ct. 289, 293-94 (1977), *rev’d on other grounds,* 375 Mass. 360 (1978); ***Library Services, Inc. v. Malden Redevelopment Auth.***, 9 Mass. App. Ct. 877, 878 (1980)(rescript).

Under the income-capitalization approach, valuation is determined by calculating a net operating income and dividing it by a capitalization rate. *See* ***Assessors of Brookline v. Buehler,*** 396 Mass. 520, 522-23 (1986). The net operating income is obtained by accounting for vacancy and rent losses and then deducting the appropriate expenses. ***General Electric Co.,*** 393 Mass. at 610; ***Pepsi-Cola Bottling Co.,*** 397 Mass. at 452-53. “The issue of what expenses may be considered in any particular piece of property is for the board.” ***Alstores Realty Corp. v. Assessors of Peabody***, 391 Mass. 60, 65 (1984).

In the instant appeals, the appellant contended that the REIT expenses were deductible operating expenses, because as a REIT, the appellant incurred expenses that were not allowed to be allocated to and deducted by the individual properties that it owned and operated. However, the appellant failed to meet its burden of proving that these REIT expenses were specifically related to the operation of the subject property, as opposed to the overall operation of the corporation. For example, IPO costs and compensation for corporate-level employees who were not shown to be managers of the subject property are related to the global operations of the corporation; they are not specifically tied to the income and expenses of the subject property. Therefore, consideration of these expenses does not aid in determining the earning capacity of the subject property. The Board thus found and ruled that the REIT expenses were not appropriate expenses to deduct in arriving at net operating income in an income-capitalization analysis.

Without inclusion of the REIT expenses at issue, the income-capitalization analyses of the appellant’s expert would yield indicated values that would be higher than the assessed values for all 3 fiscal years at issue.

Therefore, for all of the foregoing reasons, the Board found and ruled that the appellant failed to meet its burden of proving a fair market value for the subject property that was lower than its assessed value for all 3 fiscal years at issue.

Accordingly, the Board issued decisions for the appellee.

**THE APPELLATE TAX BOARD**

**By: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

 **Thomas W. Hammond, Jr. Chairman**

**A true copy,**

**Attest: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

 **Clerk of the Board**

1. For fiscal year 2015, the due date for payment of the first installment of the actual tax bill without incurring interest, and therefore, the due date of abatement applications, was February 6, 2015. *See* St. 2015, c. 10, § 62 (extending the due dates for fiscal year 2015 because of a severe blizzard on the initial due date). *See, e.g*., ***Scharf v. Assessors of Needham***, Mass. ATB Findings of Fact and Reports 2017-215, 216 n.2. [↑](#footnote-ref-1)