NO. CV 02 0098650S	:	SUPERIOR COURT
PILOT'S POINT MARINA, INC.	:	JUDICIAL DISTRICT OF MIDDLESEX
V.	:	AT MIDDLETOWN
TOWN OF WESTBROOK	:	OCTOBER 6, 2005

MEMORANDUM OF DECISION

This is a tax appeal involving the largest marina in New England, located in the town of Westbrook on Long Island Sound. The appeal challenges the valuation of the plaintiff's real property by the town of Westbrook's assessor for the revaluation year of October 1, 2001.

The subject property is an 852 boat slip marina located in the town of Westbrook (town) on the southerly side of the Boston Post Road known as U.S. Route 1. The property consists of approximately 84 acres of land situated along the Patchogue and the Menunketesuck Rivers, at a point where both rivers meet and empty into Long Island Sound. Approximately 20 to 25 acres out of the 84 acres consist of unusable wetlands. The marina is known for its efficient operations and commands such popularity that it maintains a waiting list for the rental of its boat docking slips. Indeed, the marina has the reputation as the "Cadillac" of marinas.

The assessor for the town valued the subject property on the Grand List of

October 1, 2001, at $13,037,000.[1] The plaintiff's appraiser, Tom Merola (Merola) valued the subject property as of October 1, 2001, at $10,230,000. The town's appraiser, Stephen R. Flanagan (Flanagan), valued the subject property at $13,860,000 as of October 1, 2001.

Simply stated, the subject property is unique. It is a marina with four physical locations known as North Yard, South Yard, East Yard and the Marina Village. The subject is also a going business with distinct components consisting of: 1) waterside improvements, namely, 852 boat slips; 2) winter and summer boat storage; 3) commercial buildings; and 4) residential dwellings. Utilities at the subject property consist of municipal water with sanitary sewerage provided by on-site septic systems.

The waterside component is composed of water frontage along the westerly boundary of the Patchogue River and the east side of the Menunketesuck River. The waterside improvements consist of five travel lift slips, fixed piers and floating docks for 852 rental slips, a fuel dock with two above-ground 10,000-gallon capacity gasoline and diesel storage tanks and a service dock. The slips can accommodate boats up to 130 feet

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[1] There is some confusion as to the assessor's determination of value of the subject property as of October 1, 2001. Plaintiff's appraiser lists the assessor's revaluation at $13,148,000 with an assessment at $9,125,900. See Plaintiff's Exhibit 5, p. 2. However, an assessment of $9,125,900, at 70% of fair market value, translates into a fair market value of $13,037,000. See Defendant's Post-Trial Brief, p.1, reciting the value of $13,037,000. The town's appraiser lists the assessment at $8,513,100, which translates into a fair market value of $12,161,571. See Defendant's Exhibit B, p. 26; Plaintiff's Exhibit 6, p. 26.

in length. The dockside berths have a depth ranging from seven to twelve feet. The docks also have hookups for fresh water, cable television and telephone service.

North Yard

The North Yard is located on the Menunketesuck River, separate and apart from the other locations. Entrance to the North Yard is through a security gazebo on the Boston Post Road. There are four buildings in the North Yard. The first building is the main office/paint bay and mechanics building which was rebuilt in 2003 following a fire. It is a one-story, pre-engineered metal light industrial building containing 7,500 square feet of space which includes a 1,500 square foot mezzanine area on the second floor. The ceiling height in the shop area is twenty-four feet. The remaining three buildings are pre-engineered metal light industrial buildings. One building contains 7,600 square feet and the other two buildings contain 7,425 square feet. The North Yard also contains an in-ground swimming pool, an open wood pavilion, shower/restroom facility, tennis courts, a basketball court and a volleyball court.

South Yard

The South Yard, lying along the Patchogue River, is the largest of the locations with six primary buildings. The marina office, parts department, paint bay and a large work area are located in the 15,344 square foot main building. There is also a one-story pre-engineered metal structure of 12,920 square feet of space with a small mezzanine for employee breaks. This building has a ceiling height of eighteen feet and is known as the rigging, metal working and carpentry shop. The other four buildings in the South Yard are a one-story mechanics/paint shop containing 7,344 square feet; a storage shed containing 5,011 square feet; a one-story club house containing 1,448 square feet and a one-story seasonal restaurant containing 2,226 square feet. Furthermore, the South Yard has a recreation area with a swimming pool, playscape, picnic pavilion, volleyball court, basketball court, snack bar and a shower/restroom facility. There are three additional facilities with restrooms, showers and telephones to accommodate boat owners.

East Yard

The East Yard is the smallest part of the marina with an office/clubhouse and work building comprised of 3,000 square feet. Ceiling heights span eight feet high in the office/clubhouse and twenty-six feet high on average in the work building. A one-bay industrial building used for boat repair and service is also located here. In addition, showers, restrooms, telephones and a picnic area are available.

Marina Village

There are three commercial buildings in Marina Village, located six hundred feet along the Boston Post Road, at the entrance to the subject marina. The first building, containing 3,300 square feet of space, is occupied by Boater's World and Custom Navigation. The second building is a one-story building containing a total of 7,830 square feet. It is leased to Bassett Boats for boat display, retail space and office space. The third building is an office building containing 1,800 square feet of space.

In summary, the subject property, as stated in the defendant's brief, contains "amenities [that] are numerous and include two swimming pools, two tennis courts, two sand volleyball courts, two basketball courts, a putting green, a children's playground, two clubhouses, several picnic areas, the dock decks . . . gas and diesel fuel pumps, dockside sewage pump-out, on-site propane refilling, two pavilions, several gazebos, two security gate houses, ship's store and a restaurant with seasonal outdoor dining, numerous bathroom facilities and ample off-street parking (including ample parking during the winter when the boats are stored on land)." (Defendant's Post-Trial Brief, p. 3.)

The court agrees with the opinions of the appraisers, Merola and Flanagan that: 1) the highest and best use of the subject property is its continued use as a marina and boatyard; 2) it would be inappropriate to use the cost approach to value the subject property; and 3) because the subject marina is the largest marina in New England, there is no credible comparable sale applicable to the subject under the market sales approach.

"In valuing marinas, the income approach is generally the most reliable method of arriving at value since most marinas are economic investments. Haddad, Nicholas S., *Appraisal of Marinas*, Encyclopedia of Real Estate Appraising (3d Ed. 1978), p. 881." Robertson v. Stonington, Superior Court, judicial district of New London, Docket No.

CV 95-0534631 (February 17, 1999, *Aronson, J.T.R.*). Both appraisers concede that although they considered the market sales approach to value, the most reliable method to be used in this case was the income capitalization approach to value. The court concludes that the income approach is the only credible method to determine the fair market value of the subject as of October 1, 2001.

When considering the income approach, one typically looks at the real estate as an investment. The Appraisal of Real Estate (12th Ed. 2001) p. 471. "An investor who purchases income-producing real estate is essentially trading present dollars for the expectation of receiving future dollars. . . . Anticipation is fundamental to the income capitalization approach." Id. "To apply any capitalization procedure, a reliable estimate of income expectancy must be developed. Although some capitalization procedures are based on the actual level of income at the time of the appraisal, all must eventually consider a projection of future income. An appraiser must consider the future outlook both in the estimate of income and expenses and in the selection of the appropriate capitalization methodology to use. Failure to consider future income would contradict the principle of anticipation, which holds that value is the present worth of future benefits." Id., 497. With these principles in mind, the court will examine and analyze the approach to value taken by each appraiser.

Both appraisers used the direct capitalization method to convert an estimate of a single year's income expectancy into an indication of value by dividing the net operating income (NOI) estimate by an appropriate capitalization rate. The plaintiff furnished income and expense statements to the assessor in compliance with General Statutes § 12-63c.[2] In using the income approach, both appraisers were influenced by the plaintiff's income and expense statements for the years 2000, 2001 and 2002. The appraisers were of the opinion that the plaintiff's income and expense statements represented the current market value of income and expenses for the subject property.

Analysis of Merola's opinion of value

As previously discussed, Merola, the plaintiff's appraiser, perceived the income generated by the subject as coming from various components.

With regard to the waterside component, Merola concluded that the market rate for summer slip rentals, as of October 1, 2001, was $90.00 per linear foot with an average boat length of 32 feet. With 852 boat slips, Merola found the waterside rental income to be $2,453,760. This figure is fairly close to the actual slip rental amount of $2,483,051.64

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General Statutes § 12-63c provides, in relevant part: "Disclosure of income and expense information of rental property. (a) In determining the present true and actual value in any town of real property used primarily for purposes of producing rental income, the assessor, which term whenever used in this section shall include assessor or board of assessors, shall have power to require, subject to the conditions in subsection (b) of this section, in the conduct of any appraisal of such property pursuant to the capitalization of net income method, as provided in section 12-63b, that the owner of such property annually submit or make available to the assessor not later than the first day of June, on a form provided by the assessor, the best available information disclosing the actual rental and rental-related income and operating expenses applicable to such property."

reported on the plaintiff's 2001 income statement. The average slip rentals during the years 2000, 2001 and 2002 total $2,457,301. See Defendant's Exhibit B, p. 161, 164.

Turning to the winter and summer boat storage component, Merola recognized that the subject property was unique in the local market because boats could be stored indoors during the winter season. Merola took the average rental income for winter boat storage at the subject for years 1999, 2000 and 2001 to arrive at a stabilized income of $943,834. However, recognizing that anticipation is fundamental to the income approach, the court considers it appropriate to include the year 2002 in the computation of income for the subject. Accordingly, the court averaged the years of rental income for both winter and summer storage from years 2000, 2001 and 2002 for a stabilized average income of $1,109,646. See Plaintiff's Exhibit 3; Defendant's Exhibit B, p. 161.

Considering the landside component of rental space, Merola estimated the overall market lease rate of $5.00 per square foot on a modified gross basis for the industrial, warehouse and shop portions of the property. The rate assumes that the tenant would be responsible for building maintenance and utility expenses, such has heat and electricity, while the owner would be responsible for insurance and real estate taxes. Merola applied a market rent of $10 per square foot because he ascertained that the rent paid to the plaintiff from the commercial users at Marina Village was at market level. After deducting ten percent for vacancy and collection loss, Merola arrived at $330,606 as an effective gross income (EGI) of the industrial, warehouse and shop portions of the subject and $94,770 EGI for Marina Village for a total commercial buildings EGI of $425,376. See Plaintiff's Exhibit 5, p. 61.

After an analysis of Merola's calculations of the residential income for the subject property, and its relationship to market rent, the court accepts Merola's calculations that the yearly income from the residences amounts to $48,600. See Plaintiff's Exhibit 5, p. 61. After factoring the vacancy and collection loss at a rate of ten percent, the EGI for the residences is $43,740.

Upon a detailed review of Merola's income and expense worksheet, the court concludes that the total EGI is $4,056,063, which is based upon the average rental slip income of $2,457,301 from years 2000, 2001 and 2002; the average winter and summer storage rentals of $1,109,646 from years 2000, 2001 and 2002; the industrial, warehouse and shop rentals of $425,376; the residential dwelling rentals at $43,740 and the reimbursement for electric expenses at $20,000.

Merola estimated operational expenses at $2,620,158 after considering a five percent management fee, a reserve for replacement of six percent of EGI and a contingency expense of one percent of EGI. With estimated EGI of $3,797,164 and estimated total expenses of $2,620,158, Merola arrived at NOI of $1,177,006. Capitalizing this amount at 11.5%, Merola concluded that the fair market value of the subject as of October 1, 2001, was $10,234,838, rounded to $10,230,000.

Analysis of Flanagan's opinion of value

Contrary to Merola's approach, Flanagan considered the going-concern value as a process to arrive at a fair market value of the real estate portion of the subject's business. The town previously engaged Flanagan to determine the valuation of the subject property as part of the town-wide revaluation for the Grand List of October 1, 2001. At that time, Flanagan used the income approach and concluded that the fair market value of the subject, as of the revaluation date, was $13,037,000. Flanagan's finding was based upon a determination of $1,574,338 NOI with a capitalization rate of 11.5%. Flanagan then deducted a personal property estimate of $653,000 from the total value estimate of $13,690,000. See Plaintiff's Exhibit 6, p. 129. For purposes of this appeal, Flanagan subsequently based his conclusion of value on the going business concern valuation rather than on the income approach. See Defendant's Exhibit B, p. 132.

"A going concern is an established and operating business with an indefinite future life. For certain types of properties (e.g., hotels and motels, restaurants, bowling alleys, manufacturing enterprises, athletic clubs, landfills), the physical real estate assets are integral parts of an ongoing business. The market value of . . . such a property (including all the tangible and intangible assets of the going concern, as if sold in aggregate) is commonly called its *going-concern value*." (Emphasis in original.) The Appraisal of Real Estate (12th Ed. 2001) p. 27.

"Going-concern value includes the incremental value associated with the business concern, which is distinct from the value of the real property. The value of the going-concern includes an intangible enhancement of the value of the operating business enterprise, which is produced by the assemblage of the land, buildings, labor, equipment, and the marketing operation. This assemblage creates an economically viable business that is expected to continue. The value of the going concern refers to the total value of the property, including both the real property and the intangible personal property attributed to business enterprise value." Id.

Flanagan considered the going-concern value of the subject because the plaintiff operates various businesses on the premises such as docking slip rentals and boat storage in the winter and summer. The plaintiff operates other businesses on the site, including boat and engine repair, a retail ship's store and commercial and residential property rentals.

Flanagan projected revenues by reviewing the plaintiff's actual revenues from years 2000, 2001 and 2002 as follows:

December 31, 2000	$ 9,955,083
December 31, 2001	$10,873,578
December 31, 2002	$10,981,445

See Defendant's Exhibit B, p. 135.

Flanagan's approach to valuing the real estate portion of the plaintiff's going-concern as of October 1, 2001, entailed determining the total value of the business and deducting the income and expenses unrelated to the real estate. Flanagan included items of personal property and intangibles in the deductions. Flanagan also viewed the value of the going-concern from the standpoint that an appraiser should look at future benefits, not past performance. As a result, an investor or buyer of a going-concern would look at what the business is likely to produce in the future, not what it has done in the past. See The Appraisal of Real Estate (12^{th} Ed. 2001) p. 27.

When Flanagan reviewed the plaintiff's income figures, he chose to rely on the business income figure of $10,981,445 for the year ending December 31, 2002. Recognizing that as of the date of revaluation, October 1, 2001, the income and expenses for 2002 did not exist and further recognizing that an appraiser must gauge the future of the subject business, it would be foolish to ignore the plaintiff's 2002 income and expense statement given the opportunity to consider it at the time of appraisal. "A retrospective appraisal is complicated by the fact that the appraiser already knows what occurred in the market after the effective date of the appraisal. Data subsequent to the effective date may be considered in developing a retrospective value as a confirmation of trends that would reasonably be considered by a buyer or seller as of that date." Uniform Standards of Professional Appraisal Practice (USPAP) (2004 Ed.) p. 89.

After selecting the plaintiff's revenues for the year 2002 at $10,981,445, Flanagan used the plaintiff's income and expense statement showing total cost of goods sold at $3,909,965.53 which resulted in gross profit of $7,071,479.83. See Defendant's Exhibit B, p. 161. Instead of using $4,749,058.79, the figure the plaintiff reported as its total operating expenses in 2002 and net profit of $2,322,421.04, Flanagan arrived at a reduced total operating expense of $3,709,253 by excluding officers' salaries, real estate taxes, depreciation and amortization. See Defendant's Exhibit B, p. 136, 162. Because Flanagan decreased the total operating expenses, the net profit from operations increased to $3,362,227, an amount substantially higher than the plaintiff's reported net profit of

$2,322,421.04.

Flanagan further deducted an "Other Expense" category from the $3,362,227 net profit from operations and added an "Other Income" category to arrive at a net profit of $3,520,788. See Defendant's Exhibit B, p. 136. Interest expenses were deducted from the net profit of the operation because these expenses were bank charges, bad debts and interest expenses not truly related to the valuation of real estate. Flanagan noted that "Other Income" totaling $328,881 for 2002 consisted of interest and money-lending. Although this "Other Income" appears to be unrelated to a real estate operation, Flanagan included this amount in his development of the net operating income of the subject. Flanagan arrived at the net operating income of $1,708,850 after deducting a management fee of $494,165, a reserves charge of $549,072 and a business return charge of $768,701 from the net profit of $3,520,788.

Flanagan capitalized the net operating income of $1,708,850 at 11.5 percent to arrive at a fair market value estimate of $14,860,000. The capitalization rate of 11.5 percent included a tax cap rate of 1.5 percent. Flanagan further reduced the value estimate of the real estate by $1,000,000, reflecting the depreciated personal property the plaintiff reported to the assessor for a final valuation of $13,860,000.

Flanagan and Merola recognize that the plaintiff's principal business is operating a marina. Central to the marina's operation is the rental of 852 boat slips. The marina generated additional income in years 2000 through 2002 from services that support boat owners who rent slips. These services include yard labor, mechanical labor, work order materials, fuel sales, water provisions, electricity and recreational facilities. As Merola noted, "[t]he trend is to utilize space within a marina by the marina and to limit outside vendors. Vendors that do take space must compliment marina activities such as a canvas shop, electronics supplier or boat broker. There is usually a reciprocal relationship whereby the vendor uses the marina services, such as boat storage and boatyard services that provide an additional source of revenue to the marina operator." (Plaintiff's Exhibit 5, p. 51.)

The first objective in the valuation of real estate, after considering the highest and best use of the property, is to determine the amount of income that will be generated by the real estate, namely, the marina operation and rental income from the commercial and residential properties. In the income approach, it is important to determine EGI which is "anticipated income from all operations of the real property adjusted for vacancy and collection losses." The Appraisal of Real Estate (12th Ed. 2001) p. 484. After obtaining EGI, the next step is to determine the operating expenses attached to the real estate. Deducting the operating expenses from EGI results in NOI which "is the actual or anticipated net income remaining after all operating expenses are deducted from effective gross income." Id. The value of the real estate is then determined by dividing NOI by the capitalization rate. Id., 489.

On balance, Merola's income approach to value is more credible than Flanagan's bifurcation of real estate value from going-concern value. As previously discussed, the rental of 852 docking slips and boat storage are the major income-producing activities of the subject from the waterside component. However, since Merola and Flanagan were of the opinion that the plaintiff's reported income and expenses were equivalent to market values, the court will also consider the actual income and expenses for the years 2000, 2001 and 2002 as equivalent to market value. Because the income approach is based on anticipation, income from the years 2000, 2001 and 2002 reflects this anticipation more accurately than Merola's potential gross income less vacancy and collection loss.

The court notes that Merola failed to include income related to environmental charges although he included the sum of $17,000 in his operating expense worksheet for environmental matters. Mr. Potts, the plaintiff's vice-president and general manager, testified that a one percent charge was made on all billing for environmental issues. The court assumes that the one percent charge on income offsets the $17,000 charge appearing as an operating expense attributed to reimbursement from boat owners for environmental charges.

In a similar fashion, Merola referred to a dredging charge in his income and expense worksheet in the amount of $66,000. See Plaintiff's Exhibit 5, p. 61. This charge should be removed as an operating expense because Mr. Potts testified that periodic dredging is a capital expense, not an operating expense.

The total estimated operating expense considered by the court is taken from Merola's income and expense worksheet (see Plaintiff's Exhibit 5, p. 61.), with the following modifications: the management and administration expense (shown as five percent of EGI) should be seven percent of EGI or $283,924. In the court's view, the management and administration of 852 boat slips, winter and summer boat storage, together with the management of the industrial/warehouse buildings and dwellings require a major effort on the part of management to be efficient and productive. The reserves of six percent for replacement and one percent for contingency, both expressed as a percentage of EGI, is modified to $243,364 and $40,561, respectively. Furthermore, the $17,000 environmental charge and the $66,000 dredging charge will not be considered as operating expenses. Therefore, the court finds that the total estimated operating expenses are $2,649,347.[3] This results in NOI of $1,406,716.

To arrive at the fair market value of the subject as of October 1, 2001, the court divided the NOI of $1,406,716 by 11.5 percent, the capitalization rate employed by both appraisers, resulting in a final value of $12,232,313.

Accordingly, because the court's finding of the fair market value of the subject property, as of October 1, 2001, at $12,232,313 is lower than the assessor's valuation of $13,037,000, judgment may enter in favor of the plaintiff sustaining its appeal without costs to either party.

Arnold W. Aronson
Judge Trial Referee

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In arriving at the total operating expense of $2,649,347, the court has accepted Merola's computations shown on Plaintiff's Exhibit 5, p. 61, with the stated modifications.