

COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

ARNOLD Z. MASON

v. BOARD OF ASSESSORS OF  
THE TOWN OF WINCHESTER

Docket Nos.: F263659 (FY 2002)  
F267062 (FY 2003)

Promulgated:  
February 27, 2004

These are appeals filed under the formal procedure pursuant to G.L. c. 59, §§ 64 and 65 from the refusal of the appellee to abate taxes assessed on certain real estate in the Town of Winchester under G.L. c. 59, §§ 11 and 38, for fiscal years 2002 and 2003.

Commissioner Rose heard these appeals. Commissioners Scharaffa, Gorton, and Egan, all joined him in the decisions for the appellant.

These findings of fact and report are made on the Appellate Tax Board's own motion pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32, and are promulgated simultaneously with the Board's decisions in these appeals.

*Evan Y. Semerjian*, Esq. for the appellant.

*Daniel D. McGurl*, Director of Assessments, for the appellee.

## FINDINGS OF FACT AND REPORT

On January 1, 2001 and January 1, 2002, the appellant, Arnold Z. Mason, was the assessed owner of a garden apartment complex in Winchester, known as Winchester Gardens (hereinafter sometimes referred to as "the complex" or "the subject property"). Winchester Gardens is composed of fifty-one contiguous, but separately assessed and taxed, parcels. One of the parcels contains a maintenance building and is not part of these appeals. The remaining fifty parcels each contain a two-story wood-framed duplex apartment building.<sup>1</sup> Each of the duplexes houses two side-by-side units, for a total of one-hundred rental units.

The subject property is located in the northerly section of Winchester bordering Woburn. It is situated in a geographically defined area, which fronts Bradford Road, Charles Road, Cross Street, George Road, and Verplast Avenue. The surrounding area in Winchester contains single, double, and multi-family residential and light industrial uses. Low-income residential units owned by the Winchester Housing Authority are located adjacent to the subject property. The abutting area in Woburn contains primarily commercial and industrial uses.

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<sup>1</sup> One of these fifty parcels also contains another maintenance building.

The fifty duplex buildings, which comprise Winchester Gardens, were constructed between 1960 and 1963 using prefabricated construction sections. During this period, the previous owner subdivided the complex into separate assessing parcels on mostly nonconforming lots.<sup>2</sup> The appellant purchased the subject property in 1967 under a single deed. Since its initial construction, it has been operated continuously as a rental garden apartment complex.

The fifty two-story duplexes average less than 2,000 square feet per building, and each rental unit averages less than 1,000 square feet. The units have unfinished basements and no attics or garages. Each unit has four or five finished rooms. Generally, the four-room units have two bedrooms and two bathrooms<sup>3</sup> on the second floor plus a kitchen and combination living and dining room on the first floor. The five-room units are similar to the four-room units except that the three bedrooms on the upper level are smaller than the two bedrooms in the four-room units, and the five-room units have only one bathroom on the second floor. Small half-baths have been added to the first floor of some of the units. All of the duplexes are wood framed

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<sup>2</sup> For two-family use, this residential zone in Winchester requires a parcel of 11,000 square feet. Only two of the complex's fifty parcels on appeal meet this requirement.

<sup>3</sup> Each of these units have one full and one three-quarters bathroom.

with reinforced concrete foundations. Wood shingles cover the exterior walls, and asphalt shingles cover the roofs.

The interior walls of the units are painted plaster or sheetrock with ceramic wainscot in most full bathrooms. The ceilings are painted plaster, and the floors are carpet or hardwood in the living and bedroom areas and vinyl tile or linoleum in the kitchens and bathrooms. Both units in each duplex are heated by forced hot water from a single shared boiler supplied by a single oil storage tank and are provided hot water from a single shared Aquabooster fifty-gallon tank.

For fiscal year 2002, the Board of Assessors of Winchester ("assessors") valued the fifty individually assessed parcels at \$18,607,300 in total and assessed a tax thereon, at the rate of \$11.06 per thousand, in the amount of \$205,796.72. The individually assessed parcels ranged in value from \$349,900 to \$410,200. For fiscal year 2003, the assessors valued the fifty individually assessed parcels at \$20,159,300 in total and assessed a tax thereon, at the rate of \$11.38 per thousand, in the total amount of \$229,412.83. The individually assessed parcels ranged

in value from \$379,700 to \$428,600.<sup>4</sup> For each fiscal year, the appellant timely paid the real estate taxes without incurring interest.

The appellant timely filed applications for abatement with the assessors for fiscal years 2002 and 2003 on January 22, 2002 and January 29, 2003, respectively. The assessors denied the fiscal-year 2002 applications on February 25, 2002 and the fiscal-year 2003 applications on March 24, 2003. On May 21, 2002 and April 23, 2003, the appellant seasonably filed petitions with this Board appealing the assessors' respective denials of his fiscal year 2002 and 2003 applications for abatement. On the basis of these facts, the Board found that it had jurisdiction to hear and decide these appeals.

The appellant challenged the accuracy of the assessments through two witnesses, including a real estate valuation expert; various exhibits, including his valuation expert's report; and several post-hearing submissions, including a brief and requests for findings of

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<sup>4</sup> The average assessed valuation per tax parcel was \$397,146 for fiscal year 2002 and \$403,186 for fiscal year 2003. The assessed valuations for each of the fifty parcels on appeal are listed in the individual parcel abatement computations for fiscal years 2002 and 2003 attached to the Decision, which is promulgated simultaneously with these Findings of Fact and Report, as Exhibits A and B, respectively.

fact and rulings of law. The assessors defended the assessments through the testimony of their Director and the introduction of several exhibits, including their Director's written valuation analysis.

The appellant, who has owned and managed the subject property since he first purchased it in 1967, was the first witness to testify. He described the units as containing less than 1,000 square feet of living space and being on the "smaller side for duplexes." He related that approximately two-thirds of the units were remodeled from three-bedroom and one-bath units into what are currently more readily rentable two-bedroom units with an additional three-quarters bath upstairs. Approximately ten-percent of the units are rented to low-income tenants and more than a quarter of the units are oriented sideways to the street. In addition, the units in each duplex share a single heating and hot water system. None of the units have fireplaces, air-conditioning, or garages, although some tenants purchase, on their own, window air-conditioners. Most units have outdoor tandem parking along the sides of the buildings. Each unit's kitchen is equipped with a refrigerator, dishwasher, stove, and garbage disposal.

Since its initial construction, the property has been operated and widely recognized as a rental apartment

complex with some low-income tenants. The appellant employs a rental agent and uses standard Greater Boston Real Estate Board one-year leases. Heat and hot water are supplied to the duplexes by the appellant and included in the rent, while the tenant pays for electricity. There is a resident superintendent on site and a twenty-four hour emergency telephone service. The appellant provides weekly trash pick-up through a private contractor and full ground maintenance. The landlord is also responsible for all building maintenance and repairs as well as replacements for appliances.

The appellant further testified that it would be impractical and financially unattractive to sell the duplexes individually. The units are not only small and share certain utility systems, but in some cases, they are oriented sideways to the street, more in keeping with an apartment complex than with private residences. In addition, he testified that financial penalties associated with his mortgage on the complex for releases from the mortgagee for sales of individual duplexes would render such sales economically impractical. In the appellant's opinion, it would be difficult to find buyers willing to purchase duplexes or units within duplexes located in the

midst of the apartment complex.<sup>5</sup> The Board found that the appellant's testimony was credible.

James R. Johnston, a professional real estate appraiser, was qualified by the Board to testify as the appellant's real estate valuation expert.<sup>6</sup> Mr. Johnston first described his investigations leading toward his appraisal of the subject property. According to his testimony, he viewed and inspected the property; he examined the neighborhood; and he researched the relevant market for not only two-family sales and assessments in Winchester but also apartment sales within five miles of the subject and apartment assessments in Winchester. Mr. Johnston also analyzed the relevant rent rolls and income and expense statements for the subject property. In addition, he interviewed the appellant and a local real estate broker. He also consulted with a major residential appraisal office and researched relevant sales information using appropriate issues of *Banker & Tradesman* and the Multiple Listing Service. Finally, he consulted with several contractors regarding costs associated with renovating and installing equipment in the duplexes and

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<sup>5</sup> In 1986, at the behest of the Winchester Housing Authority, the appellant sold it an outer duplex for low-income rental housing. There were no sales before this unique transaction and none after.

<sup>6</sup> The assessors acknowledged and orally stipulated to Mr. Johnson's qualification as a real estate valuation expert.

individual units that comprise the subject apartment complex.

Relying on his investigations, consultations, and research, Mr. Johnston first determined that the highest and best use of the subject property for the fiscal years at issue was its continued use as an apartment complex. In finding this highest and best use, he observed that, for over thirty years, the appellant had operated and continues to manage the subject property as a rental apartment complex with centralized management and services, and Winchester Gardens is recognized as a rental apartment complex throughout the area. He also noted that the duplexes within the complex have never been marketed as independent two-family houses, and the units within them share heating and hot water systems. In addition, none of the units contain fireplaces, a garage, or any other special amenities. Many of the duplexes do not face the street, and all of them are relatively small and situated on small lots when compared to two-family properties in Winchester.

Mr. Johnston also believed that an alternative use, such as an owner exit strategy of conversion to independently owned two-family houses was possible, provided that substantial adjustments were made in

comparable sales and assessments to reflect the deficiencies in the subject property. He observed that the duplexes within the complex would require costly retrofits to compete as and with typical independent two-family houses in Winchester. In addition, because of the significant number of units, any sales of the subject property's duplexes would require a multi-year absorption period. The time required to renovate and sell the parcels would result in a substantial loss of rental income. Moreover, because of the complex's relatively undesirable location and reputation as a rental complex, its duplexes would have low market appeal to prospective purchasers. On the basis of these facts and observations, Mr. Johnston determined that the subject property's highest and best use was its continued use as an apartment complex with a possible long-term exit strategy of conversion to independent two-family residences.

To estimate the value of Winchester Gardens for the fiscal years at issue, Mr. Johnston did not apply the cost approach because of the age and character of the subject property. Rather, he considered sales and assessments of two-family properties and duplexes in Winchester, assessments of other apartment rental complexes in Winchester, sales of apartment complexes within a five-mile

radius of the subject property, and a direct capitalization of potential rental income approach. In his sales and assessment comparison approach, Mr. Johnston derived a price per square foot of living area by using sales of what he considered to be reasonably comparable two-family properties. For fiscal year 2002, he focused on sales in 2000. For fiscal year 2003, he focused on sales occurring in 2001 and early 2002. After downwardly adjusting sales prices fifteen percent for various physical, locational, and economic factors, he found adjusted per-square-foot unit values of \$137.70 and \$142.80 for fiscal years 2002 and 2003, respectively.

Mr. Johnston also applied the identical fifteen-percent downward adjustment on the assessments of these same sale properties and derived an adjusted per-square-foot value of \$130.90 and \$136.00 for fiscal years 2002 and 2003, respectively. He similarly adjusted downward the fiscal year 2002 and 2003 assessments of several duplexes in Winchester that he deemed somewhat comparable to the ones in the subject complex and derived an adjusted per-square-foot value of \$125.80 and \$136.85 for fiscal years 2002 and 2003, respectively.

Using these per-square-foot calculations for his two-family sales, two-family non-duplex assessments, and two-

family duplex assessments, Mr. Johnston obtained values for Winchester Gardens for fiscal year 2002 of \$13,680,000, \$13,005,000, and \$12,498,000, respectively, and values for fiscal year 2003 of \$14,525,000, \$13,512,000, and \$13,512,000, respectively.

In addition, as a check on values, Mr. Johnston considered the assessments on other apartment rental complexes in Winchester and sales of apartment complexes within five miles of the subject property. The per-square-foot values derived from the assessments of these complexes for fiscal years 2002 and 2003 were \$117.00 and \$124.00, respectively. The per-square-foot value for both fiscal years derived from their sales was \$89.00.

Mr. Johnston also used an income capitalization approach to value the subject property. After examining the subject property's rent rolls and rentals from two-family houses in Winchester and apartments from the area, he determined that the higher actual rents paid by the newer tenants at the subject complex for the more recently renovated units best reflected the market. His market rents of \$1,369 for fiscal year 2002 and \$1,567 for fiscal year 2003 produced potential gross incomes of \$1,642,800 and \$1,880,400, respectively.

For his vacancy rate, Mr. Johnston reviewed Metro Boston Market vacancy rates and the subject's experience in calendar years 2000 through 2002. He found that the Metro Boston Market experienced a five-percent vacancy rate during the relevant time period, while the subject experienced a stabilized vacancy rate of only three percent. He selected the subject's stabilized rate of three percent for his vacancy rate for both of the fiscal years at issue resulting in effective gross incomes of \$1,593,516 for fiscal year 2002 and \$1,823,988 for fiscal year 2003.

To determine the most appropriate operating expenses to use in his methodology, Mr. Johnston reviewed the subject's actual expenses for calendar years 1999 through 2001 and compared them with industry ranges as reported by the Institute of Real Estate Management ("IREM") report on 2001 Boston Apartment Operating Costs. Except for management costs, he adopted the subject's actual expenses as being the most reasonable and reflective of the market for the fiscal years at issue. For management costs, Mr. Johnston adjusted the actual expenses downward to five percent to better reflect the market for garden apartments as reported by IREM. His operating expenses totaled \$516,686 or 32.4% of effective gross income for fiscal year

2002 and \$525,055 or 28.8% of effective gross income for fiscal year 2003.

For his reserves for replacement of capital equipment items, Mr. Johnston considered the actual costs for replacing appliances, carpet and flooring, heating units, and roofs over economic lives of fifteen, seven, twenty, and twenty years, respectively. His calculations in this regard for both of the fiscal years at issue are summarized in the below table.

<u>Items</u>	<u>Units</u>	<u>Unit Cost</u>	<u>Life</u>	<u>Tot. Cost</u>	<u>Cost/Unit/Yr</u>
Appliances	100	\$ 916	15 years	\$ 6,107	\$ 61
Carpet/Flooring	100	\$1,000	7 years	\$14,286	\$143
Heating Units	50	\$5,600	20 years	\$14,000	\$140
Roof	50	\$1,800	20 years	<u>\$ 4,500</u>	<u>\$ 45</u>
<b>TOTAL RESERVE</b>				<b>\$38,893</b>	<b>\$389</b>

After subtracting operating expenses and reserves from the effective gross incomes, Mr. Johnston calculated net operating incomes of \$1,037,938 for fiscal year 2002 and \$1,260,040 for fiscal year 2003.

For his capitalization rate, Mr. Johnston considered quarterly investor survey data for capitalization rates on multi-family investments from the *Korpacz Report*. For fiscal year 2002, he relied on data for the fourth quarter of 2000 and the first quarter of 2001. For fiscal year 2003, he relied on data from the fourth quarter of 2001 and

the first quarter of 2002. He also calculated capitalization rates of 9.06% and 9.01% for fiscal years 2002 and 2003, respectively, using the band-of-investment technique. Relying on both the *Korpacz Report* and his band-of-investment calculations, Mr. Johnston selected a base capitalization rate of 9.25% for both of the fiscal years at issue. After adding each fiscal year's effective tax rate to the base rate, he used overall capitalization rates of 10.36% and 10.39% in his income capitalization methodology for fiscal years 2002 and 2003, respectively.

Mr. Johnston then divided his net operating incomes of \$1,037,938 and \$1,260,040 for fiscal years 2002 and 2003, respectively, by the total capitalization rates that he had calculated for the particular fiscal year to arrive at indicated values for the subject property of \$10,022,575 for fiscal year 2002 and \$12,129,767 for fiscal year 2003.

In reconciling the various estimates of value that each of his methods found for the subject property, Mr. Johnston weighted them, as shown in the following table, to reach his final estimates of value for fiscal years 2002 and 2003 of \$11,846,000 and \$13,162,000, respectively.

	<u>Fiscal Year</u> <u>2002</u>	<u>Fiscal Year</u> <u>2003</u>	<u>Valuation</u> <u>Weight</u>
<b>Sales Comparison</b>			
2 Family Sales	\$13,680,000	\$14,525,000	20%
<b>Assessment Comparison</b>			
2-Family Non-Duplex	\$13,005,000	\$13,512,000	20%
2-Family Duplex	\$12,498,000	\$13,512,000	20%
<b>Income Approach</b>			
Direct Capitalization	\$10,023,000	\$12,130,000	40%
<b>Final Estimate of Value</b>	\$11,845,800	\$13,161,800	100%
<b>ROUNDED VALUE</b>	<b>\$11,846,000</b>	<b>\$13,162,000</b>	

Finally, because each of the parcels that comprise the subject property were assessed separately by the assessors, Mr. Johnston allocated his rounded values for the subject property to the fifty separately assessed parcels on appeal that comprise the complex by making specific adjustments for differences between individual parcels and the average parcel. These modifications included positive adjustments for extra bathroom fixtures and new exterior siding, as well as a \$7,000 increase in value for the parcel located at 2-4 Verplast Avenue to account for one of the complex's two maintenance garages that was located on that parcel. His modifications also included negative adjustments for locations on busy streets, sideways orientations, as well as older kitchens, windows, and roofs. The allocated values assigned by Mr. Johnston to the parcels ranged from a low of \$216,400 to a high of \$256,900 for fiscal year 2002 and a low of \$242,000 to a high of \$283,600 for fiscal

year 2003. The average value per parcel for fiscal years 2002 and 2003 was \$236,914 and \$263,236, respectively.

Daniel D. McGurl, the Director of Assessing for Winchester, presented the appellee's case in support of the assessments. He testified that the appellant purchased the complex in 1967 for approximately \$1.2 million. He believed that the fifty two-family duplexes in the complex, which were separately assessed, could be sold individually or converted to condominiums. He observed that many of the units had been renovated and the property is well maintained.

To support the assessments, Mr. McGurl conducted a sales analysis of eight properties in Winchester improved with two-family dwellings that he considered comparable to the subject duplex properties. He identified one of these properties, 5-7 Cardinal Street, as being particularly comparable to the subject duplexes because it had been built at the same time, with the same materials, and by the same builder as the appellant's properties. This Cardinal Street property sold in August 2000, several months before the first assessment date, for \$410,000 or approximately \$208 per square foot. Mr. McGurl observed that the appellant's duplexes were assessed at an average of \$188 per square foot.

While the other seven properties in his comparable sales analysis were admittedly not as comparable to the subject duplexes as the Cardinal Street property, Mr. McGurl found that their sale prices averaged \$191 per square foot. After applying a ten-percent adjustment to account for the subject duplexes' additional bathroom and what he considered to be the subject duplexes' superior condition, he determined that their per-square-foot value was \$210, well above the average per-square-foot assessed value of the subject duplexes. Apparently, Mr. McGurl did not consider or adjust for any other possible differences between his comparables and the subject duplexes based on, for example, the sizes of the lots, the sizes and styles of the homes, the heat and hot water systems, and the locations of the properties.

Mr. McGurl also performed a cost approach using one land sale for \$225,000, plus \$11,000 in demolition costs, and conversations with builders about the per-square-foot cost to build a single-family home. To value an improvement comparable to one of the subject duplexes, he reduced the \$125 per-square-foot cost to build a 1,980 square-foot home by twenty percent to reflect depreciation, and then raised that \$198,000 cost "a bit" to account for two living units, instead of one. Finally, Mr. McGurl

increased the value of the land to \$250,000 because of the subject duplexes' larger parcels. Based on his cost approach, he estimated the value of each of the subject duplexes at approximately \$448,000. Mr. McGurl also admitted that this approach was "not the best." He did not use income capitalization methodology to estimate the value of Winchester Gardens.

On the basis of all of the evidence, the Board found that the highest and best use of the subject duplexes was their continued collective use as a rental garden apartment complex. In making this finding, the Board relied on its subsidiary findings that the subject duplexes always have been, presently are, and, according to the owner, will continue to be centrally operated as a single garden apartment complex with the landlord providing virtually all of the essential services for the tenants. The complex's reputation and image throughout the community has always been, and continues to be, as a rental apartment complex with some low-income units.

The Board also relied on its findings that a conversion to independently owned two-family homes would necessitate a lengthy and costly transformation. The evidence clearly showed that a conversion would require a substantial number of duplexes to be marketed and tenants

to be evicted. Furthermore, the duplexes lacked many amenities that might make them more attractive to prospective purchasers, such as garages, fireplaces, and separate heating and hot water systems. In addition, sales of the individual duplexes that comprise the complex would be difficult because many of duplexes do not face the street; they share small common yards; they are located in a relatively undesirable location; and they are small and configured for rental to, as opposed to purchase by, two working professionals.

In addition to the large number of duplexes to be sold, a negative impact on value would result from flooding the market with more duplexes than demand would warrant. Moreover, selling the duplexes would probably involve a substantial loss of rent and significant financial penalties from the existing mortgagee. The Board believed that the appellant, as a successful and astute businessman, would utilize his property in a maximally productive manner and, therefore, if sales of the individual parcels or condominium conversion would generate more revenue than the present residential-apartment-complex use, the appellant would have pursued those alternatives sometime during his approximate thirty-five-year period of ownership and operation of the complex.

The appellant's valuation expert also identified a highest and best use equivalent to the one adopted by the Board, while the assessors, who through their assessments and Director's valuation discussion obviously regarded the subject duplexes as individual properties, never directly addressed or analyzed the issue. On the basis of all of these facts and circumstances, the Board found that the highest and best use of the subject duplexes for the fiscal years at issue was their continued collective use as a rental garden apartment complex. The Board did not believe that selling the properties as individual residential duplexes was their highest and best use for the fiscal years at issue. Given its subsidiary findings, the Board found that Winchester Gardens' continued operation, as a rental garden apartment complex, was the more physically possible, legally permissible, financially feasible, and maximally productive use.

To estimate the value of the subject complex, the Board found that, with several changes, the income capitalization approach used by Mr. Johnston was the most appropriate methodology to use for this income-producing complex. The Board found that the cost approach was not appropriate for valuing the complex because of the subject property's age and periodic renovation, as well as the

unreliability of estimating accrued depreciation. The imprecise cost methodology discussed by Mr. McGurl, who was not an architect or engineer, was not helpful. Moreover, this property is not special purpose, unique, or newly constructed property. It is susceptible to being appropriately valued by one or more of the other accepted methods.

The Board further found that the sales and assessment comparison approaches were not appropriate to use here to value the subject property because the purportedly comparable properties offered by both parties were, for the most part, not demonstrably comparable to the subject duplexes. To the extent that these properties might have been considered comparable, the differences between these comparables and the subject duplexes were not adequately accounted for. Mr. McGurl's written analysis, in particular, was not a true appraisal report and lacked the requisite detail, explanation, adjustments, and analysis to render it reliable. His over-reliance on one sale was misplaced. He admitted, with respect to land sales, that one purportedly comparable sale does not make a market. The same is true with respect to improved property. Moreover, to the extent that this property was comparable to the subject duplexes, it still required some downward

adjustments to account for certain characteristics that were superior to the duplexes at Winchester Gardens, such as its location.

The appellant's valuation expert also failed to show comparability between his purportedly comparable properties and the subject duplexes. His blanket fifteen-percent adjustments applied to all of his comparables for physical, locational, and economic factors was not adequately supported and lacked credibility. In addition, his reliance on the assessments of properties, which had recently sold, was overemphasized. Assessed values attributable to properties do not trump their timely sale prices. For these reasons, as well as the subject complex's standing in the relevant marketplace as an income-producing property, the Board relied on the income capitalization approach to estimate the value of the subject property.

In its income capitalization methodology, the Board essentially adopted the approach used by the appellant's valuation expert, Mr. Johnston, with several alterations. First, the Board used an average monthly rent of \$1,560 and \$1,725 per unit, for fiscal years 2002 and 2003, respectively, instead of the \$1,369 and \$1,567 rents that Mr. Johnston used for those same fiscal years. The Board

based its rents on the ones suggested by Mr. Johnston, the ones reported for Winchester in *The Greater Boston Housing Report Card 2002* (excerpts of which were included in the appendix of Mr. Johnston's appraisal report), and the approximate fourteen percent increase in the rents used by Mr. Johnston in his income capitalization methodology from the first fiscal year at issue to the second.<sup>7</sup>

Second, after adopting Mr. Johnston's stabilized vacancy rate of three percent as appropriate and indicative of the market for the subject property for the fiscal years at issue, the Board also adopted Mr. Johnston's expenses of 32.4% and 28.8% of effective gross income for fiscal years 2002 and 2003, respectively, after stabilizing them at thirty percent for both of the fiscal years at issue. The Board found, just as Mr. Johnston had, that these expenses properly reflected the market. In addition, the Board accepted, as reasonable under the circumstances, Mr. Johnston's calculation of \$38,892 for reserves for each of the fiscal years at issue.

For its overall capitalization rates, the Board included tax factors, like Mr. Johnston, but instead of using 9.25% as its base capitalization rate for both of the

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<sup>7</sup> The rents charged to low-income tenants were included in Mr. Johnston's analysis of Winchester Gardens' actual rent rolls and were considered by the Board.

fiscal years at issue, the Board selected 9.00%. In finding its capitalization rate of 9.00%, the Board relied exclusively on Mr. Johnston's band-of-investment technique as the most appropriate method to use for this income-producing property. The Board found that the assumptions that he applied in this technique were reasonable. The Board also considered the long-term continuity, viability, and relative safety associated with this particular investment.

In this way, the Board found that the potential gross rental incomes for fiscal years 2002 and 2003 were \$1,872,000 and \$2,070,000, respectively. The effective gross incomes, after accounting for the three-percent vacancy rates, were \$1,815,840 and \$2,007,900, respectively. The net operating incomes, after subtracting expenses and reserves of \$544,752 and \$38,892 and \$602,370 and \$38,892 for fiscal years 2002 and 2003, respectively, were \$1,232,196 for fiscal year 2002 and \$1,366,638 for fiscal year 2003. The Board then divided these net-operating income figures by overall cap rates of 10.11% for fiscal year 2002 and 10.14% for fiscal year 2003 to find fair cash values of \$12,187,893 for fiscal year 2002 and \$13,477,692 for fiscal year 2003, which it then rounded to \$12,200,000 and 13,500,000, respectively. A summary of the

Board's income capitalization methodology is contained in the following table.

	<u>Fiscal Year 2002</u>	<u>Fiscal Year 2003</u>
<b>Potential Gross Income</b>		
100 units x \$1,560 & \$1,725/mo.	\$ 1,872,000	\$ 2,070,000
Vacancy @ 3.00%	(\$ 56,160)	(\$ 62,100)
<b>Effective Gross Income</b>	<b>\$ 1,815,840</b>	<b>\$ 2,007,900</b>
Expenses @ 30%	(\$ 544,752)	(\$ 602,370)
Reserves	(\$ 38,892)	(\$ 38,892)
<b>Net Operating Income</b>	<b>\$ 1,232,196</b>	<b>\$ 1,366,638</b>
<b>Capitalization Rate</b>	rate 9.000	rate 9.000
	factor <u>1.106</u>	factor <u>1.138</u>
	<b>Overall 10.11</b>	<b>Overall 10.14</b>
Indicated Value	\$12,187,893	\$13,477,692
<b>Rounded Value</b>	<b>\$12,200,000</b>	<b>\$13,500,000</b>

On the basis of these findings, the Board found that the appellant met his burden in proving that the subject property was overvalued for both of the fiscal years at issue. The Board further found that the fair cash value of the subject property was \$12,200,000 for fiscal year 2002 and \$13,500,000 for fiscal year 2003. The duplex properties that comprised the subject complex had been assessed for a total of \$18,607,300 and \$20,159,300 for fiscal years 2002 and 2003, respectively. Accordingly, the Board abated \$70,864.74 and \$75,782.83 in taxes for fiscal years 2002 and 2003, respectively.

Before issuing its decisions in these appeals, the Board ordered the parties under Rule 33<sup>8</sup> to allocate the fair cash values that it had found for the complex as a whole for each of the fiscal years at issue to the fifty parcels on appeal that comprise the subject property.<sup>9</sup> The assessors notified the Board that they would not submit any such allocations. The appellant allocated the fair cash values of the complex as found by the Board among the fifty parcels by adjusting *pro rata* the original allocations contained in his valuation expert's report. Because the appellant's *pro rata* adjustments under Rule 33 are based on his valuation expert's original allocations, which the Board found were well-reasoned, and because the assessors elected not to submit any allocations of their own or challenge the appellant's, the Board adopted the ones submitted by the appellant. The allocations and abatements for each of the parcels on appeal, as well as their corresponding docket numbers, are attached to the Decision, promulgated simultaneously with these Findings of Fact and Report, in Exhibits A and B.

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<sup>8</sup> See 831 CMR 1.33.

<sup>9</sup> Neither the appellant nor his valuation expert argued that the fifty-first parcel, which was not subject to these appeals, should be part of the allocation. Accordingly, the Board did not include it in its allocation.

## OPINION

There are two principal issues in these appeals: the highest and best use of the subject duplexes that comprise Winchester Gardens and their value for fiscal years 2002 and 2003. The Board found and ruled that the highest and best use of these properties was their continued use as a rental garden apartment complex. The Board further found and ruled that, under the circumstances, the properties were overvalued. The Board relied upon the following principles in deciding these appeals for the appellant.

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 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). Accordingly, fair cash value means its fair market value. *Id.*

"Prior to valuing the subject property, its highest and best use must be ascertained, which has been defined as the use for which the property would bring the most." *Tennessee Gas Pipeline Co. v. Assessors of Agawam*, 26 Mass. App. Tax Bd. Rep. 226, 234 (citing *Conness v. Commonwealth*, 184 Mass. 541, 542-43 (1903)); *Irving Saunders Trust v. Assessors of Boston*, 26 Mass. App. Ct. 838, 843 (1989) and

the cases cited therein. A property's highest and best use must be legally permissible, physically possible, financially feasible, and maximally productive. APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE at 305-308 (12<sup>th</sup> ed., 2001). See also **Skyline Homes, Inc. v. Commonwealth**, 362 Mass. 684, 87 (1972); **DiBiase v. Town of Rowley**, 33 Mass. App. Ct. 928 (1992) (rescript opinion). In determining the property's highest and best use, consideration should be given to the purpose for which the property is adapted. APPRAISAL INSTITUTE, *supra*, at 315-16; **Tennessee Gas Pipeline Co.**, 26 Mass. App. Tax Bd. Rep. at 235.

In the present appeals, the appellant's valuation expert and this Board found that the continuation of the subject property's existing use as a rental garden apartment complex constituted its highest and best use. The assessors never directly addressed or analyzed the highest-and-best-use issue, although they clearly believed, as evidenced by their actions, that each of the fifty parcels should be assessed and valued separately. Even though the appellant's valuation expert also suggested that a possible exit strategy for the appellant was to sell the parcels individually, the Board found too many impediments

to that strategy to render it likely or desirable for the fiscal years at issue.

The Board made numerous subsidiary findings supporting its highest-and-best-use finding. The Board found that the subject duplexes always have been, presently are, and, according to the owner, will continue to be centrally operated as a single garden apartment complex with the landlord centrally providing virtually all of the essential services for the tenants. At all relevant times, the complex's reputation in the community has been as a rental apartment complex with some low-income tenants. The Board also found that a conversion to independently owned two-family homes would necessitate a lengthy and costly transformation. In addition, sales of the individual duplexes would be difficult. Many of duplexes do not face the street; they share small common yards; they are located in a relatively undesirable location in Winchester; they are small; the units within them share heating and hot water systems; and they are configured for rental to, as opposed to purchase by, working professionals. Because of the large number of duplexes to be sold, there likely would be a negative impact on value from flooding the market with a greater supply than demand would warrant. Moreover, selling the duplexes would probably involve a substantial

loss of rent and significant financial penalties. The Board recognized that the appellant was an astute businessman and his maintenance of the subject duplexes as a garden apartment complex likely represented their maximum production for the fiscal years at issue.

In *M.J. Realty Trust v. Board of Assessors of Reading*, 7 Mass. App. Tax Bd. Rep. 194 (1986), the Board confronted a similar situation to the instant appeals. In *M.J. Realty Trust*, the assessors urged the Board to value a garden apartment complex as condominiums where a master deed had been filed about five years earlier but none of the apartments had actually been sold or converted into condominiums. As in the present appeals, the Board found that the highest and best use of the Reading apartments was their continued use as an apartment complex. *Id.* at 197. The Board relied on the facts that the Reading apartments were being used as apartments, not condominiums, and their location made them less desirable as condominiums than other condominiums in town. *Id.* Similarly, the Board found in the present appeals that the duplexes, at least for the fiscal years at issue, were better suited to be part of an apartment complex because, among other reasons, they were in a relatively undesirable location in Winchester and they were less desirable for separate

ownership than other duplex and two-family properties in town.

Considering all of these facts and circumstances, the Board found and ruled that the highest and best use of the subject duplexes for the fiscal years at issue was their continued collective use as a rental garden apartment complex. Such a use was legally permissible, physically possible, financially feasible, and maximally productive.

Generally, real estate valuation experts, the Massachusetts courts, and this Board rely upon three approaches to determine the fair cash value of property: income capitalization, sales comparison, and cost reproductions. See *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 Redev. Assocs. v. Assessors of Taunton*, 393 Mass. 293, 295 (1984). Use of the income capitalization method is appropriate when reliable market sales data are not available. *Assessors of Weymouth v. Tammy Brook Co.*, 368 Mass. 810, 811 (1975); *Assessors of Lynnfield v. New England Oyster House*, 362 Mass. 696, 701-

702 (1972); *Assessors of Quincy v. Boston Consolidated Gas Co.*, 309 Mass. 60, 67 (1941).

In the present appeals, the appellant's valuation expert used, in addition to an income capitalization approach, sales and assessments of two-family properties in Winchester as well as sales and assessments of nearby apartment complexes as part of his blended approach to value the subject property for the fiscal years at issue. The assessors used a comparable sales method and a cost approach. The Board found that the vast majority of the properties upon which both parties relied were not shown to be sufficiently comparable to the subject duplexes or apartment complex. To the extent that they were, the adjustments, or lack thereof, were inadequately supported. Moreover, the use of certain properties' assessments in conjunction with their timely sale prices to value the subject property was misplaced. Their relevant sale prices, not their assessments, were the more appropriate measures for determining fair cash value. See APPRAISAL INSTITUTE, *supra*, at 417 ("the market value of a property is related to the [sale] prices of comparable, competitive properties"). See also *Foxboro Associates v. Board of Assessors of Foxboro*, 385 Mass. 679, 682 (1982) ("sales of property usually furnish strong evidence of market value");

and *Lodi v. Assessors of Braintree*, 2003 Mass. A.T.B. Adv. Sh. 263, 270 (Docket No. F266179, June 27, 2003) (ruling that a comparable property's lower assessed value did not demonstrate the overvaluation of that appeal's subject property where the comparable's recent sale proved otherwise). Under the circumstances, the Board found and ruled that the sales comparison or the sales and assessment comparison approaches were not appropriate techniques to use to value Winchester Gardens for the fiscal years at issue.

"[T]he introduction of evidence concerning value based on [cost] computations has been limited to special situations in which data cannot be reliably computed under the other two methods." *Correia*, 375 Mass. at 362. The Board found that the value of the subject property could be determined using other approaches. The appellant's valuation expert did not use a cost approach because of the age and character of the subject property. The assessors' witness, who was not an architect or engineer, used a rough cost approach, which the Board found was without merit. On this basis, the Board found and ruled that the cost approach was not an appropriate technique to use to value Winchester Gardens for the fiscal years at issue.

The income capitalization method is appropriate for valuing real estate that is improved with a residential rental garden apartment complex. See, e.g., **M.J. Realty Trust**, 7 Mass. App. Tax Bd. Rep. at 197. The appellant's valuation expert also used a direct income capitalization methodology to estimate the value of the subject real estate. The Board found and ruled that a direct income capitalization methodology was the most appropriate approach for estimating the value of Winchester Gardens for the fiscal years at issue. "Direct capitalization is widely used when properties are already operating on a stabilized basis and there is an ample supply of comparable [rentals] with similar risk levels, incomes, expenses, physical and locational characteristics, and future expectations." APPRAISAL INSTITUTE, *supra*, at 529. The Board found that there were an adequate number of rentals to support the use of a direct income capitalization methodology to estimate the value of Winchester Gardens for the years at issue. Under this approach, the property's capacity to generate income over a one-year period is analyzed and converted 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). Net operating income is obtained by subtracting expenses from gross income. **Assessors of Brookline v. Buehler**, 396 Mass. 520, 523 (1986). Rental subsidies are relevant considerations when determining a property's fair cash value. See **Community Development Co. of Gardner v. Board of Assessors of Gardner**, 377 Mass. 351, 354-56 (1979); **Hampton Associates v. Assessors of Northampton**, 24 Mass. App. Tax Bd. Rep. 167, 174-76 (1998). The capitalization rate should reflect the return on investment necessary to attract investment capital. **Taunton Redevelopment Associates**, 393 Mass. at 295. The "tax factor" is a percentage added to the capitalization rate "to reflect the tax which will be payable on the assessed valuation produced by the [capitalization] formula." **Assessors of Lynn v. Shop-Lease Co.**, 364 Mass. 569, 573 (1974).

To determine the appropriate rents to use in its income capitalization methodology, the Board considered: the actual rents that Mr. Johnston used and determined reflective of the market, the ones reported for Winchester in *The Greater Boston Housing Report Card 2002*, and the approximate fourteen-percent increase in the rent, from one fiscal year to the next, that Mr. Johnston used in his methodology.

For vacancy and credit loss, the Board adopted Mr. Johnston's stabilized rate, which he based on the property's actual experience as compared to generally higher rates in the market. The Board found that Mr. Johnston's rate was reflective of the market for the subject property and appropriate for the fiscal years at issue. For operating expenses, the Board also adopted Mr. Johnston's estimates as appropriate under the circumstances. For reserves, the Board used Mr. Johnston's values because it found his methodology and underlying data reasonable under the circumstances. "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).

After reviewing Mr. Johnston's underlying data and methodology, the Board used the capitalization rate that he developed using his band-of-investment technique. The Board found that his assumptions were reasonable and this rate properly accounted for the properties' long-term continuity, viability, and relative safety for investment purposes.

Finally, to allocate the fair cash value of Winchester Gardens to the fifty parcels for each of the fiscal years at issue, the Board adopted the approach that the appellant

submitted in response to the Board's Order under Rule 33. Essentially, the appellant allocated the fair cash values of the complex as found by the Board among the fifty parcels that comprise the complex by adjusting *pro rata* the original allocations contained in Mr. Johnston's valuation report. The assessors elected not to submit a response to the Board's Order under Rule 33 or to challenge the appellant's allocation. Under the circumstances, the Board found that the appellant's approach was reasonable.

The mere qualification of a person as an expert does not endow his testimony with any magic qualities. ***Boston Gas Co.***, 334 Mass. at 579. "The board [is] not required to believe the testimony of any particular witness but it [can] accept such portions of the evidence as appear to have the more convincing weight. The market value of the property [can] not be proved with mathematical certainty and must ultimately rest in the realm of opinion, estimate, and judgment . . . (citations omitted). The board [can] select the various elements of value as shown by the record and from them form . . . its own independent judgment." ***Boston Consolidated Gas Co.***, 309 Mass. at 72. See also ***North American Philips Lighting Corp. v. Assessors of Lynn***, 392 Mass. 296, 300 (1984); ***New Boston Garden Corp. v. Assessors of Boston***, 383 Mass. 456, 473 (1981); ***Jordan***

**Marsh Co. v. Assessors of Malden**, 359 Mass. 106, 110 (1971). In these appeals, the Board was persuaded from a consideration of all of the evidence that Winchester Gardens was overvalued for fiscal years 2002 and 2003.

The burden of proof is upon the appellant 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). "By holding that the assessment is entitled to a presumption of validity, we are only restating that the taxpayer bears the burden of persuasion of every material fact necessary to prove that its property has been overvalued." **General Electric Co. v. Assessors of Lynn**, 393 Mass. 591, 599 (1984). 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." **Id.** at 600 (quoting **Donlon v. Assessors of Holliston**, 389 Mass. 848, 855 (1983)).

The Board found and ruled here that, upon consideration of all of the evidence, the appellant met its burden in proving that the property was overvalued for fiscal years 2002 and 2003.

Therefore, the Board decided these appeals for the appellant.

**APPELLATE TAX BOARD**

By: \_\_\_\_\_  
James D. Rose, Member

A true copy,

Attest: \_\_\_\_\_  
Clerk of the Board