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Important (or at least interesting) Connecticut case developments during calendar 2007

1. **Cost approach for older buildings scored: *Moutinho v. City of Bridgeport*, Superior Court, Judicial District of Bridgeport, April 11, 2007**

In a tax appeal challenging the market value of a few humdrum, aged industrial buildings in the City of Bridgeport as of October 1, 2003, both sides' appraisers used the cost approach. The owner's appraiser's estimated value was $1,620,000; the City's appraiser's estimated value was $2,570,000, a fairly wide delta!

The Superior Court hearing the case wrung its hands a bit. "(A) comparison of the (two appraisers') values demonstrates how unreliable it is to use the cost approach in the valuation of (this) property. There is such a disparity in the selection of replacement cost and depreciation rates as to make a choice between one or the other more of a toss of a coin."

2. **How (not) to value a nuclear power plant!** ***Dominion Nuclear Connecticut, Inc. v. Town of Waterford,*** **Superior Court, #03-0566126.**

Thirty days of trial, preceded by weeks of pretrial discovery, concerning the market value of the Millstone II nuclear power plant located in the Town of Waterford came to a close on November 8, 2007. Reducing the market value of the entire facility by approximately $200 million, a Connecticut judge trial referee released a 62 page decision which examined the parties' expert witnesses' contentions exhaustively.

In reviewing the parties' valuation positions, the court noted the importance of the dispute because "Millstone is the largest electrical generating station in New England and produces roughly half of Connecticut's electrical power." The subject site, located on the north shore of Long Island Sound, sprawls across approximately 526 acres and boasts 2.5 miles of coastline.

- The court criticized the Town's appraiser for asserting that the value of the facility had increased since its acquisition by the plaintiff in 2000 after he had also noted that "due to legal license expirations and technology obsolescence, nuclear facilities lose their potential value as they age."
- The Town's appraiser was criticized for failing to consider the impact of this facility, having started up in 2002 after being shut down in 1996 and the need to transition from a regulated to a deregulated environment.

- The Town's appraiser was chastised for estimating the value of the facility at $1.343 billion as of October 1, 2002, the valuation date involved in the litigation, "when a short time earlier, on March 31, 2001, (the property owner) in an arms-length transaction, purchased the whole business . . . . for a total of $1.288 billion. Suggesting a problem with this position, the court observed, "(w)hether the market value of the subject property increased to such an extent and in such a short period of time . . ., as reported by (the Town's appraiser), is an issue that must be analyzed very closely."
- The court critiqued the same appraiser's reliance on the business enterprise valuation approach. "The factors (involved in the business enterprise approach) may increase the value of the total business, but not necessarily the value of the tangible real and personal property, which generally depreciates with time."
- Highest and best use (HBU) analyses by both appraisers received a judicial pummeling.

The property owner's appraiser concluded that the highest and best use of the land which the court observed, "formed the underpinnings of the nuclear power plant, was for industrial park development . . . ." Harumph! The court stated, "(T)he highest and best use of the subject as a continuation of its present use is

incompatible with a finding that the highest and best use of the land, in isolation from the present improvements on the land, is for a different use." While recognizing that the HBU of the land should be considered as if it was vacant, the court maintained that, here, "(d)oing so only leads to speculation which adds nothing in terms of valuation." From the facts presented, there was no reasonable probability that on October 1, 2002 the land could or would be put to a use different from that of the present use."

- Considering the long remaining economic life attributed to the improvements by both sides' appraisers, it was improper for them "to have considered demolishing the existing nuclear power plant in order to treat the land as vacant."
- Use of the cost approach also received a judicial pasting. Among the matters discussed by the court was the plaintiff's appraiser's determination that while the replacement cost new of the facility was over $6.6 *billion*, after deducting "excess capital costs", employed as the equivalent of functional obsolescence, the depreciated cost/value was a mere $981.5 *million*!
- The plaintiff's appraiser used the reproduction cost new (RCN) method even though he also opined that "in today's energy-producing market, a nuclear power generating plant would not be constructed. Instead, a gas powered generating plant would be constructed."

- The “excess capital cost (concept)”, while judicially recognized elsewhere, did not make sense here “because a gas generating plant could not have been constructed at Millstone in any event . . . . (It) would be pure speculation to assume that at this period of time, a gas power plant could be used when (the plaintiff) had (only) recently purchased a nuclear power plant.”
- Throwing up its hands, the court stated that while it was “convinced that the valuation placed upon the real and personal property comprising (this nuclear power plant) as of October 1, 2002 was in excess of its fair market value . . . the presentation by the experts . . . leaves the court in a quandary because of a lack of faith in the methods and processes used in their determination of fair market value.”
- The court’s value conclusion was based on the 2001 purchase price, the parties’ agreement on value for a prior tax appeal, the arms length transaction reflecting the purchase of the facility on March 31, 2001 and the parties’ agreement that intangibles should be deducted from the purchase price in computing the value of real and personal property.
- In exasperation, the court grossed up the purchase price, deducted the agreed upon value of the intangibles from the purchase price and determined a fair market value as of October 1, 2002 of $1.122 billion as compared with the assessor’s value

of $1.214 billion, the plaintiff's claim of $1.0 billion and the Town's expert's conclusion of $1.344 billion!

3. **Highest and best use: When to press the point --- and when not to do so.**

The highest and best use of three contiguous parcels of underdeveloped land owned and controlled by the same taxpayer and located in a planned travel zone were for commercial use, not for a park.

This is one of those instances where a property owner picks up the valuation cudgels even though he is not an appraiser and without the assistance of counsel. His extensive background in real estate, noted by the court in its opinion, did not help him here . . .

His first mistake was arguing that the parcels could not be merged by the assessor for valuation purposes even though he owned/controlled all three. Further confirming the maxim about those who chose to represent themselves in contested cases, his array of comparable sales properties were all located in the flood zone even though, as the court dryly noted, none of his three parcels were "similarly located".

His major point was that several prior special permit applications to develop the property had been denied. Thus, he concluded, the only use that he could legally conduct was a park. While agreeing that numerous development applications had been denied for these properties since 1991, several of them followed by land use litigation, it was difficult for the court to ignore the fact that as of the date of value, the plaintiff had yet another

application pending for the three parcels to develop a lifestyle retail center consisting of over 100,000 square feet.

Accepting that there was no assurance that this application would be approved, the Town's appraiser pointed to the zoning regulations which also permitted hospitality, service and recreational facilities as specially permitted uses. Multi-family housing was also deemed to be reasonably probable.

***Sakon v. Glastonbury,* April 27, 2007.**

4. **Controversial exemption case decided.**

Saint Joseph Living Center owns and operates a skilled nursing facility in the Town of Windham consisting of 120 beds licensed for long term chronic and short term rehabilitation services.

The corporation is a non-stock nonprofit corporation exempt under Section 501(c)(3) of the Internal Revenue Code. It is also affiliated with the Roman Catholic Diocese of Norwich; the Bishop of Norwich is the chairman of the corporation and appoints its board of directors. Although the facility was constructed with funds provided by a for profit partner, Saint Joseph bought out the for profit partner seven years after the facility opened and financed that purchase with tax exempt bonds issued by the Connecticut Health and Educational Facilities Authority.

Sounds like a slam dunk win for Saint Joseph in its law suit to obtain an *ad valorem* tax exemption – right? Wrong.

The court was not impressed. A tax exemption from the Internal Revenue Service does not automatically entitle an entity to a tax exemption for

local *ad valorem* purposes. Under Connecticut law, and under the law of many other states, not only must the property belong to a tax exempt organization which is organized exclusively for a charitable purpose, it must also be used exclusively for that charitable purpose. Why was Saint Joseph Living Center not able to meet that test here?

- All of its revenues came from Medicare, Medicaid and private pay patients. Any unreimbursed costs derived from the care of Medicaid patients are picked up by the private pay patients in their rates. In other words, "patient care is covered by the patients themselves, not from the Living Center."
- Free care is not provided to any patient.
- The facility operates so efficiently that in certain years it is able to generate additional cash flow which it turns over to the Diocese.
- The existence of a chapel for religious services within the facility is of no legal significance. The chapel does not have a separate physical existence from the rest of the real estate and cannot qualify for an exemption under a separate provision in Connecticut law pertaining to houses of religious worship.
- Delivery of health care to the elderly is not a charitable purpose when they or third parties are paying for it. It would be a different matter if the elderly for whom care was being provided

lacked capital, a steady income and were financially were unable to provide for themselves.

- Property which produces rents, profits or income may not obtain the exemption.
- Saint Joseph Living Center was unable to establish that there was any financial burden created by the operation of the facility; it receives no outside monetary support.
- It admits no indigent patients.
- Its operations do not lessen the burden on society or tax payers "since", the court observed, "it receives compensation for services rendered."

Saint Joseph Living Center, Inc. v. Town of Windham, **February 23, 2007.**

5. **Environmental contamination, remediation costs and value.**

This is the third, and hopefully last round in condemnation litigation which began in 1994 when a piece of contaminated industrial real estate in the Town of Windham was condemned and $1.00 was awarded as just compensation. The basis for the token award was the environmentally contaminated nature of the site. In the two cases which made their way to the Connecticut Supreme Court, compensation was increased to $1.75 million after Connecticut's highest court determined that evidence about contamination was admissible, as it did have a bearing on value.

In this final chapter, the condemnee sought to recover the $2.7 million deducted on account of contamination from its compensation award from a

prior owner of the property whose negligence allegedly caused the contamination.

Because the condemnee had not taken any steps to remediate the condition prior to the condemnation and therefore was not seeking reimbursement for actual costs incurred but, rather, was seeking to recover estimated remediation costs deducted from the condemnation award, the party causing the problem could not be held liable to it.

This is an interesting result which avoids a windfall to the condemnee while furthering a social policy to encourage clean up rather than the purchase of environmentally compromised properties in the path of condemnation.

ATC Partnership v. Coats North America Consolidated, **(December 4, 2007).**

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