

# VERMONT DEPARTMENT OF TAXES

## TECHNICAL BULLETIN

**TAX:** Property Tax

**Number:** TB-68

**SUBJECT:** Valuing Properties Consisting of  
Buildings on Leased Land

**ISSUED:** December 1, 2014

**STATUTORY REFERENCE:** 32 V.S.A. § 3481; 32 V.S.A. § 3608

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### Introduction

The Supreme Court of Vermont recently held that location-related factors may be included to establish the appraisal value of a building located on leased land. *Lesage v. Town of Colchester*, 2013 VT 48. This document provides guidance to municipalities on a process for establishing a fair market value for buildings on leased land.

This guidance does not apply to perpetual leases. Vermont treats the holders of perpetual leases as the effective owners of the underlying land, which is different from how it treats holders of short-term leases. 32 V.S.A. § 3610. This guidance only applies to the valuation of buildings owned by holders of non-perpetual leases.

Under Vermont law, buildings and land are both “real estate” and should be valued for property tax purposes at ***fair market value***. Accordingly, buildings located on leased land must be assessed for tax purposes at ***fair market value***. A determination of fair market value includes tangible and intangible elements that affect the value of real estate on the market.<sup>1</sup>

### Valuing Properties Consisting of Buildings Located on Leased Land

Establishing an appraisal value for a property that consists of a building on leased land should account for the value of the building and any intangible elements intimately entwined with the real property. Location is an example of an intangible element that is intertwined with the value of a building. A house on leased land on the waterfront will more than likely have a different value than the same house on a leased lot in a suburban setting. That difference is an example of an intangible element that would affect the fair market value of the property for property tax purposes.

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<sup>1</sup> When a building is located on leased land, the value of the fee interest in the land itself should not be included in the fair market value of the building.

## **Valuation by Sales Comparison Method**

The Supreme Court in the *Lesage* decision affirmed the general principle that where there is data based on recent sales of comparable properties, the sales comparison approach to valuation is the preferred method to capture the market value of the intangible elements influencing the value of a property consisting of a building on leased land. The comparison of arm's length sales of similar properties should reveal the range of values the market has assigned to the intangible elements of a similar group of properties. It is essential that the sales comparison data include properties with the same or similar intangible elements as the property under consideration.

For the purpose of determining the intangible value associated with a building's location, a municipality may follow this method:

**Step 1.** Determine a schedule of values by: (1) assembling data from arms-length sales of comparable properties (buildings on leased land with similar location characteristics); (2) determining the replacement cost new less depreciation of the building alone (contributory value); and (3) analyze the difference between the sales price of the arms-length sales of comparable properties and the contributory value of the building. The difference is likely to be attributable to the intangible value associated with the location.

**Step 2.** Identify additional factors that contribute to the value of the location such as views, topography, access, availability of utilities and services, and size of the leased property. To the extent the impact of these factors can be quantified as influencing the value of the building they may be used as adjustments when valuing a property consisting of a building on leased land.

**Step 3.** Combine the value of the building established using the same methodology as is applied to other buildings in the municipality and the value of the intangible elements determined by applying the values from the table of values created by the process generally identified in Step 1 and adjusted by those factors which the municipality can quantify as affecting the value as described in Step 2 to establish the appraisal value for the property. ***The value schedule and any adjustment factors that are applicable should be applied uniformly to all properties of similar type within the municipality.***

Valuation using sales comparison may be supplemented with a cost approach analysis (replacement cost new less depreciation – "RCNLD") but not entirely replaced with RCNLD. The cost approach to valuation without other data is least likely to result in a reasonable estimate of the market value of a building on leased land as RCNLD does not account for the value of the intangible elements that affect the fair market value of such a building.

## **Alternative Valuation Methods**

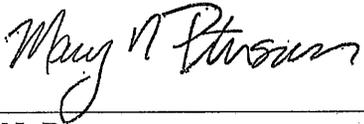
### *Valuing Buildings on Leased Land Used to Produce Income*

For income-producing commercial and industrial properties, the income approach is recommended. Commercial property on leased land is highly dependent on location and lease revenue is very likely to reflect a superior or inferior location. Buildings in a good location are likely to return a higher income resulting in a higher capitalized value. Income and expense data will account for the value of intangible elements.

### **What is an Intangible Element Intimately Intertwined with a Building?**

An intangible element is intimately intertwined if it is necessary for the property to function. It is necessary to the function of the property if it affects what a buyer is willing to pay or if it is legally defined as part of the real property. For example, a membership to a condominium association is necessary to the "function" of a condominium because it is a required part of ownership. *Barrett v. Town of Warren*, 2005 VT 107, ¶ 12. Therefore, the intangible interest in the membership should be included in the market value.

Dated this 1<sup>st</sup> day of December, 2014



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Commissioner of Taxes