

SUPERIOR COURT
OF THE DISTRICT OF COLUMBIA
TAX DIVISION

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SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

WATERFRONT ASSOCIATES,	:	
	:	
Petitioner,	:	
	:	
v.	:	2005 -CVT - 8658
	:	
DISTRICT OF COLUMBIA,	:	
	:	
Respondent.	:	

MEMORANDUM OPINION AND ORDER

This matter came before the Court for trial on Petitioner, Waterfront Associates' ("Petitioner" or "taxpayer") appeal from an assessment for real property taxes on the property known as 401 M Street, SW, Washington, D.C. ("Subject Property" or "Property"). The parties filed a Joint Pre-Trial Statement including stipulations pursuant to Super. Ct. Tax R. 11(b). At the Pretrial Conference, the Plaintiff agreed that the taxpayer was not required to prove that the assessment was incorrect or flawed at trial. The remaining issue for trial was the determination of the estimated market value of the Subject Property as of January 1, 2004. Upon consideration of the stipulations, the evidence adduced at trial, and having resolved all questions of credibility, the Court finds that the correct estimated market value as of January 1, 2004 is \$47,700,000. The Court makes the following:

FINDINGS OF FACT

I. Background.

A. The Subject Property.

1. The Subject Property is owned by the District of Columbia as successor to RLA Revitalization Corporation (RLARC). The property is subject to a 99-year ground lease to Petitioner Waterfront Associates LLC, a District of Columbia limited liability corporation whose members are K/FCE Management LLC, a District of Columbia limited liability corporation, and B&R Waterfront Properties LLC, a Delaware limited liability corporation. By agreement with RLARC, Petitioner Waterfront Associates LLC is obligated to pay all real estate taxes assessed against the Subject Property.

2. The Subject Property is located at 401 M Street, S.W., Square 542, Lot 89, in the District of Columbia. The property was formerly known as Waterside Mall, but has been re-named Waterfront. The site includes 584,655 square feet of land in a "super-block" and is improved with two 12-story office towers and a 3 story retail mall built in 1971 -1972. The Environmental Protection Agency (EPA) leased the office space until September, 2002 when it moved out. As of the value date, all of the office space had been vacant for over a year. There were some small retail tenants still in place as well as a Safeway, CVS and Bank of America.

B. Assessment and Appeal.

3. As of the valuation date at issue in this case, January 1, 2004, all real property in the District of Columbia was reassessed every year. 9 DCMR § 305.1 (2008). The assessment for Tax Year 2005 for the property was as follows:

Land	\$121,622,650
Improvements	<u>\$ 2,000,000</u>
Total	\$123,622,650

4. For Tax Year 2005, all real property within the District of Columbia was divided into three classes for tax purposes. The Subject Property is in class two, which includes most commercial real property. The Tax Year 2005 tax rate for class two was \$1.85 per \$100 of assessed value. As such, the real property taxes for the 2005 Tax Year on the Subject Property were \$2,287,019.02.

5. After receiving its assessment from the District of Columbia, the Petitioner filed administrative review appeals with the Real Property Assessment Division on April 1, 2004. After meeting with the property assessor, Petitioner received First Level Appeal Notification of Decisions confirming the assessments. The Petitioner timely filed an appeal to the Board of Real Property Assessments and Appeals ("BORPAA") on August 19, 2004. After an oral hearing, BORPAA notified Petitioner of its decision to sustain the assessment. The taxpayer timely paid the real estate taxes, and pursuant to D.C. Official Code § 47-3303, it timely filed a petition in the Tax Division of the Superior Court challenging the assessment of the Subject Property for Tax Year 2005.

II. Evidence Adduced at Trial

A. Witnesses

6. The Petitioner called two witnesses at trial -- Gordon Fraley, development manager employed by Vornado, and Harry A. Horstman, III, MAI. Vornado formed a limited liability company with Forest City Enterprises and

Bresler & Reiner, Inc. known as Waterfront Associates to redevelop the Subject Property. Mr. Fraley has worked at Vornado and its predecessor almost exclusively on this project since 2001. He started as a financial analyst and was promoted several times to his current position of Development Manager. Mr. Fraley testified to history of the redevelopment of the Subject Property. Petitioner's appraiser, Harry A. Horstman, III, MAI, was offered by Petitioner as an expert in commercial real estate valuation, and Respondent stipulated to his qualifications.

Mr. Horstman is a long-time appraisal expert, teacher of appraisal courses at the American University, and a Member of the Appraisal Institute ("MAI"). He has over 25 years of experience as an appraiser. He is a licensed appraiser in Maryland, Virginia and the District of Columbia. He has been active and has held many leadership roles in the Appraisal Institute. Mr. Horstman has performed many appraisals for many uses: for use by developers and lenders and for tax purposes. He has testified on many occasions as an expert appraiser regarding office and other commercial buildings. The Court accepted Mr. Horstman as an expert witness.

7. Mr. Horstman prepared an appraisal report for Tax Year 2005 which was admitted into evidence as Petitioner's Exhibit 4. He concluded that the Subject Property had an estimated market value of \$44,400,000 for property for the valuation date of January 1, 2004. He later revised his value to \$47,700,000 rounded. The Court finds Mr. Horstman to be a credible witness and accepts his conclusions as to the value of the Subject Property. The Court further finds that his

value accurately reflects the “estimated market value” of the Subject Property as defined by D.C. Official Code § 47-802(4).

8. Respondent called two witnesses as well. Its first witness was Eric Jenkins, Development Manager in the District of Columbia Office of the Deputy Mayor for Planning and Economic Development. Mr. Jenkins testified concerning certain documents maintained by his office related to the redevelopment of the Subject Property. The District of Columbia presented its expert appraiser, Ryland L. Mitchell, III, MAI. He has qualifications that are similar to those of Mr. Horstman, and has 35 years of experience as an appraiser. It was revealed in cross-examination that Mr. Mitchell prepared three different valuations: his first value was \$85,000,000, the second was \$100,000,000, and the final value was \$95,000,000. Petitioner's Exhibits 5 and 6; Respondent's Exhibit 1. Although this Court accepted Mr. Mitchell as an expert, this Court finds that Mr. Horstman performed a much more thorough and reliable analysis than did Mr. Mitchell.

B. Redevelopment of Subject Property

9. Mr. Fraley testified that, in 1999, the owners began evaluating options for the future of the property. The owner at that time, Bresler and Reiner, Inc., entered into an agreement with Kaempfer (now Vornado) and Forest City Enterprises to re-position the property. The new partnership, which became Waterfront Associates, entered into negotiations with the District of Columbia Office of the Deputy Mayor for Planning and Economic Development, and the parties executed a Memorandum of Understanding (MOU) in September 2001. Petitioner's Exhibit 1. The terms of the MOU included extending the 99-year

ground lease by 20 years, extending the Central Employment Area (CEA) to include the site, and re-opening 4th Street through the middle of the site. The MOU also specified a phased development of the property. The extension of the ground lease was important so that the owners could obtain financing for the new development. The inclusion of the site in the CEA was so that the owners could compete for federal government leases.

10. Mr. Fraley testified that the ownership sought and obtained approval for the first stage of a Planned Unit Development (PUD). Petitioner's Exhibit 2. The PUD was effective November 28, 2003, about a month before the valuation date herein. The order approved a change in zoning for parts of the property from C-3-B to C-3-C. It also approved the development of 2,526,500 square feet -- including 2,126,500 square feet of office space and 400,000 square feet of residential space in two phases. The Zoning Commission order included a requirement for a minimum of 30,000 square feet for a grocery store.

11. The existing Safeway grocery store is under a long-term lease at a low rent due to expire in 2020. Safeway has a total of 33,443 square feet and is located on the southeast corner of the site with frontage on M Street, SW. Mr. Fraley described a series of discussions between Safeway and the developers regarding the location of the store in the new development. The developers offered Safeway several locations within the new project, but Safeway rejected all of them. Safeway wanted its standard layout, wanted to remain with frontage on M Street, and wanted to remain open during the redevelopment of the site. As of the value date, no agreement had been reached, and Safeway was entitled to remain in its existing

location until 2020. As a result, the owners planned to develop the project around the existing Safeway.

12. The Subject Property was also under lease to a CVS store and a Bank of America branch. The CVS lease ran until the end of 2008, and the Bank of America lease ran until the end of 2007. CVS had 13,713 square feet and Bank of America had 4,882 square feet. To redevelop the site, the owners would have to either buy out the leases and convince the tenants to move out or negotiate a temporary relocation of the tenants and move them back into the new development.

13. Mr. Fraley testified that the developers had been marketing the project to potential office tenants, primarily federal government tenants, since 2002. The owners responded to several requests for proposals including for the Transportation Safety Administration. Each prospective tenant signed leases for other projects. As of the value date, they had no leads on any government leases for the site. He also testified that Fannie Mae expressed an interest in the project in December, 2003, just prior to the valuation date. However, he testified that the parties were just talking and that Fannie Mae had not signed a lease or even a letter of intent. Due to the size and complexity of the project, and the current market conditions, Mr. Fraley testified that the owners would wait to begin construction until they signed a lease or leases for at least 40% of the planned office space.

C. Market Conditions as of the Value Date

14. Mr. Horstman described the state of the economy and the real estate market as of the valuation date. Following the national economic slowdown in 2000 and collapse of the telecommunication sectors, the national economy was dealt

another blow by the terrorist attacks of September 2001. The region had negative absorption of office space from the end of 2000 into 2003, when absorption started to show some improvements. In response to the attacks, the Federal government and government contractors focused on security-oriented ventures, igniting re-development and revitalization in the Washington, D.C. metropolitan area. The real estate market, including both residential and commercial, was enjoying price appreciation and increasing sales volume. Faced with rising prices and a dwindling supply of prime sites, re-development activity spread to transitional locations previously considered too "pioneering", such as the northeast New York Avenue corridor, the M Street corridor of the southeast Washington waterfront district, predominantly residential neighborhoods north and east of the CBD, including Shaw and Columbia Heights, and north of Massachusetts Avenue (NoMa). There were several new residential developments and office developments, all located in the Northwest quadrant of the city.

15. The Subject Property is located in the Southwest market of the District of Columbia. The Southwest market includes the area bounded by the National Mall on the north, South Capitol Street on the east, the Anacostia River to the south and the Washington Channel/Tidal Basin to the west. This market is divided into three submarkets: (1) the area north of I-395 Southwest-Southeast Freeway to the Mall; (2) the "near Southwest" market south of I-395 and north of P Street, SW; and (3) the area south of P Street, SW, known as "Buzzard's Point." Mr. Horstman described the history of the Southwest market and how the construction of the interstate highway (I-395) created a concrete barrier that cut off much of Southwest

psychologically and physically from the neighborhoods to the north. Only two buildings were built in the ten years prior to the value date in the Southwest, but both are located north of the freeway.

16. The Subject Property is located in the near Southwest submarket, which is south of the freeway. This neighborhood is mostly residential in character. The Arena Stage is two blocks away and the Southwest Waterfront is about three blocks away. A plan to re-develop the Anacostia Waterfront was approved in late 2003; this is a large scale and complex project and will take years to complete. As of the value date, there had been no new construction of office or residential projects in the Subject Property's submarket south of the freeway in almost 20 years.

D. Highest and Best Use

17. As part of the appraisal process, the appraiser must examine the highest and best use of the site as if vacant and also as improved. Developing an opinion of highest and best use for the Subject Property is central to a proper estimation of its market value. There are four criteria in evaluating a property's highest and best use: legally permissible, physically possible, financially feasible and maximum productivity. The Dictionary of Real Estate Appraisal, p. 135. Both Mr. Horstman and Mr. Mitchell concluded that the existing improvements did not have any value and thus concluded that the highest and best use of the property as improved was the same as if vacant. The legally permissible use is that set out in the Zoning Commission Order approving the first stage of the Planned Unit Development. Redevelopment of the site is also physically possible.

18. The primary focus in evaluating the highest and best use of the Subject Property is what use is financially feasible. Mr. Horstman conducted a thorough analysis of the Washington DC real estate market, the Southwest market and the near Southwest submarket, south of the I-395 Southeast-Southwest freeway. He did a marketability study of both the office market and residential market. Mr. Horstman did what is known as a Level B or inferred analysis of the office market and a Level C or fundamental analysis of residential market. With regard to the office market for the Subject Property, Mr. Horstman testified that no office buildings had been constructed in the immediate vicinity in 20 to 30 years. Although the District's downtown office market was still strong, there was a huge pipeline of over 4 million square feet competing with the project. Demand for the subject site was dependent on capturing a large build-to-suit tenant or government agency. Thus, Mr. Horstman concluded that the office use was a speculative long-term hold.

19. With regard to the residential market, Mr. Horstman also did both an inferred analysis and fundamental analysis. He concluded that the highest and best use of the Subject Property on the value date was that a buyer would hold the property for future development for a medium-term, probably five years. He noted, *inter alia*, that no market rate apartments or condominiums had been constructed in the neighborhood in over 20 years, and that there was only limited support for the proposed project. He found, therefore, that new residential development at this location was not supported at the time, even with optimistic growth assumptions.

20. By contrast, Mr. Mitchell failed to conduct a marketability study of either the office or residential markets. He simply concluded that the highest and best use was the proposed redevelopment of the property. He also concluded that the property was ready for development and that a buyer would not wait to begin construction.

E. Valuation of Subject Property

21. There are three generally accepted approaches to the valuation of real estate. They are the comparable sales approach, cost approach and capitalization of income approach. An appraiser must consider all three approaches, but may rely on only one approach with an explanation as to why the other approaches are not considered applicable or relevant. Land is always valued as if vacant and available for future development. Uniform Standards of Appraisal Practice (USPAP), Standard Rule 1-3(b) and other rules and The Appraisal of Real Estate (12th ed.) at 334. See, also, 9E v. District of Columbia, Tax Docket Nos. 5240-92; 5783-93, Judge Cheryl Long, April 22, 1996. In valuing land, there are four procedures that may be used: sales comparison, allocation, extraction and income capitalization. Both Mr. Horstman and Mr. Mitchell used the sales comparison approach. Mr. Mitchell also did a form of income capitalization, a discounted cash flow analysis also known as a subdivision analysis.

22. This Court finds that only Mr. Horstman used accepted appraisal methodology to value the land and that his valuation is well supported. This Court accepts Mr. Horstman's land value of \$44,700,000.

1. Petitioner's Expert's Valuation

23. Mr. Horstman explained that there were very few land sales that were similar to the Subject Property due to the large size of the site, the highest and best use and the stage of development of the project. He identified twelve transactions that settled between December 1999 and a contract entered into in December 2003. He noted that they varied significantly but are useful in bracketing most of the attributes of the Subject Property. The sales that he identified needed to be analyzed and adjusted for differences in size, location, proximity to metro, market conditions, as well as for conditions of sale. In addition, Mr. Horstman adjusted each of the comparables to reflect the impact of the existing leases held by CVS and Bank of America as well as the Safeway lease.

24. Mr. Horstman testified that he consulted with several retail brokers regarding the impact of the CVS and Bank of America leases. After these consultations, he concluded that normally the owner would have to negotiate a buyout of the leases. However, he opined, successful businesses are reluctant to leave so that if an alternate site is available, the parties negotiate a relocation. In light of the status of two leases in question, Mr. Horstman concluded that the owner would negotiate such a relocation which would include cash, moving expenses and tenant built-out costs. The cost would be \$0.42 per square foot of FAR (floor area ratio) in comparison to the comparable sales.

25. The Safeway lease had a much larger impact. The Safeway is located in a prime location with frontage on M Street with a lease at low rents through 2020. As of the value date, the owners and Safeway had not come to an agreement on relocation so the owners were proceeding with plans to develop the site around

Safeway in its existing location. This would cause delays in the development of the southeast section of the new project until 2020 or 17 years. Mr. Horstman testified that in a staged development, the discount should only be for the delay caused by the lease; he estimated an adjustment of only 5 years. Mr. Horstman reviewed land discount rates in effect as of the value date and determined that the appropriate rate was 15%. At a discount rate of 15% for 5 years, the discount factor is approximately 50%. However, because the Safeway lease only impacts 13.9% of the property, the result is a 7% discount applicable to all the comparable sales.

26. After analyzing the comparable sales and applying adjustments for the impact of the CVS and Bank of America leases, the Safeway lease, conditions of sale, market conditions, location, size / economy of scale, site – shape and proximity to metro, Mr. Horstman arrayed the sales as to the magnitude of adjustment. The sales bracket the subject property and provide a basis for comparison. Based on this analysis, Mr. Horstman concluded a rate of \$22.50 per square foot of FAR or \$56,846,250.

27. From his conclusion of land value, Mr. Horstman added \$3 million for the contribution of the existing office towers. Then he deducted demolition costs. Mr. Horstman revised his demolition costs after he learned that the figures provided to him reflected costs as of October, 2007 and had not been discounted to the value date. The discounted cost for asbestos removal and interior demolition of the structure was \$3,781,890, and the discounted cost to demolish the mall to make way for the re-opening of 4th Street was \$8,064,900. He also deducted \$347,200 for the present value of the future cost of demolishing the Safeway store. He concluded

that the market value as of January 1, 2004 of the subject property was \$47,700,000 including \$44,700,000 for the land and \$3,000,000 for the improvements.

2. Respondent's Expert's Valuation

28. Mr. Mitchell also did a sales comparison approach. He analyzed the sales in three groups: "bulk land sales", office land sales and residential land sales. The bulk land sales were analyzed for the purpose of developing an opinion of value for the entire property. He used the office and residential land sales in analyzing the potential development of segments of the property for a discounted cash flow analysis.

29. In his comparable bulk land sales, Mr. Mitchell used three of the same sales that Mr. Horstman used. The sale prices of the three sales in common ranged from \$17.46 to \$35.22 per square foot of FAR. While Mr. Horstman concluded \$22.50 per square foot of FAR, in the middle of the range, Mr. Mitchell concluded \$40.00 per FAR, higher than all the comparables. Thus, Mr. Mitchell concluded that all of the sales were inferior to the Subject Property. Mr. Horstman undertook a much more well-informed and thorough analysis. Unlike Mr. Horstman, Mr. Mitchell made no adjustment to the comparable sales for the impact of the existing leases. He failed to account for the cost to a potential purchaser of relocating the CVS and Bank of America. He also failed to account for the impact of the long term Safeway lease, including the fact that, as of the value date, the developer planned to develop the site around the existing Safeway. Mr. Mitchell also failed to distinguish the Subject Property's location in the near Southwest submarket from the rest of the Southwest market north of I-395 Southeast-Southwest freeway. This Court

finds that a buyer would take into account the impact of the CVS and Bank of America leases and well as the impact of the Safeway lease and that it was error for Mr. Mitchell to fail to take these factors into account in his valuation.

30. Mr. Mitchell's analysis included an extraordinary assumption: he assumed that Fannie Mae would occupy a portion of the office space in the new development. An extraordinary assumption is one which presumes uncertain information to be factual. If found to be false, these assumptions could alter the appraiser's opinion. Anytime an appraiser makes an extraordinary assumption, he or she is required to disclose the assumption clearly and conspicuously in the appraisal report. The Appraisal of Real Estate, pp. 56, 618. However, Mr. Mitchell failed to disclose his assumption that Fannie Mae would occupy a portion of the office space in his appraisal. Mr. Mitchell relied on an article published in the *Washington Business Journal* on December 15, 2003, in which the reporter wrote that Fannie Mae was in negotiations with the owners. A source from Fannie Mae was quoted as saying that Fannie Mae "was exploring whether the Waterside Mall site, among other options, can address our evolving real estate needs." Mr. Mitchell did not speak with anyone from the ownership or Fannie Mae to confirm the story or ascertain details of the negotiations. He simply assumed that the mere expression of interest, without a signed lease or even letter of intent, would substantially increase the value of the Subject Property. Employing this assumption, Mr. Mitchell adjusted the bulk land sales upward as compared with the Subject Property. Mr. Horstman testified that if there was an executed lease, he would give it weight in the valuation process and that an offer or letter of intent

would be given less weight. Mr. Horstman testified that participants in the market would not give any weight to a mere expression of interest. This Court finds that Mr. Mitchell's reliance on a mere expression of interest was error.

31. After concluding his value using the bulk land sales at \$40 per square foot of FAR or \$94,000,000, Mr. Mitchell deducted demolition costs of \$6,000,000. He testified that this figure was from an appraisal report prepared by another appraiser; he did not do any independent research to estimate the demolition costs nor did he break out the costs as between interior and the demolition of the mall to make way for the re-opening of 4th Street. Included in the \$6 million figure was \$1 million for asbestos removal. However, he admitted that in a prior appraisal of the same property he suggested that \$3 million would be required to address the asbestos issue.

32. In this analysis, Mr. Mitchell assumed that the property would be subdivided and sold off in pieces over a period of four years. He therefore performed a type of discounted cash flow analysis also known as a subdivision analysis. This type of analysis is appropriate when the highest and best use of the property is to be subdivided. When the subdivision is not the highest and best used, this discounted cash flow analysis is not appropriate. The Appraisal of Real Estate, p. 342. Here, the owner had just obtained development approval for development as a single lot of record, making his assumption faulty. Moreover, even if it had been an appropriate method, Mr. Mitchell failed to take into account appropriate deductions for cost of subdividing the site. He did not deduct numerous costs including, but

not limited to, infrastructure costs such as moving the subway entrance, building roads, carrying costs, costs for management and marketing, and insurance. He again failed to account for the impact of the Safeway lease.

33. In his discounted cash flow analysis, Mr. Mitchell assumed that construction of 1,000,000 square feet of office space in the Southwest market would begin in the first year, or 2004. He also assumed that the developers would demolish the existing improvements in the first year. Mr. Mitchell then assumed that in the second year, another 1,000,000 square feet of office space would be started in Southwest and that 750,000 square feet of office space would be started at the Subject Property. In the third year, another 1,000,000 square feet of office space would be started in Southwest, another 750,000 square feet would be started at the Subject plus 200,000 square feet of residential space. By year four, he assumed, all of the planned space at the development would be under construction including another 1,000,000 square feet of office space in Southwest. Based on his office land sales and residential land sales -- all of which were located in the Northwest section of the City -- Mr. Mitchell concluded that the office land would sell for \$75.00 per FAR and the residential land would sell for \$45.00 per FAR. He assumed these rates would grow at 6% per year.

34. Mr. Mitchell's assumptions were inconsistent with the market experience at the time and the planned development of the site. He assumed that four million square feet of new office space would be started in four years when, in the past ten years, only 996,000 square feet had been commenced in the entire Southwest, none of it in the near Southwest submarket. Further, the owners were

planning a phased development over a period of ten to fifteen years in part to address the issue of the Safeway. Assuming annual growth at 6% per year was inconsistent with the growth rate at the time, especially for the near Southwest submarket.

35. Mr. Mitchell prepared two other valuations of the property prior to trial. At trial, he testified that his conclusion of value was \$95,000,000. However, it was revealed that he had prepared a preliminary valuation dated June 12, 2007 at \$85,000,000. Petitioner's Exhibit 5. The preliminary valuation did not include the assumption that Fannie Mae would occupy space in the new project. He testified that, after he prepared the preliminary appraisal, he discovered the *Washington Business Journal* article. (However, he admitted he had spoken with a representative of the Office of Tax and Revenue about Fannie Mae prior to issuing his preliminary opinion.) Then, based only on the article, he increased his value from \$85 million to \$100 million. Petitioner's Exhibit 6. However, in his valuation at \$100 million, he admitted that he failed to deduct demolition costs from his discounted cash flow analysis but did deduct demolition costs from the bulk comparable land sales. As a result, he revised his value again, to \$95,000,000. Respondent's Exhibit 1. The fact that Mr. Mitchell issued three different opinions of value ranging from \$85 million to \$100 million is a factor in the Court's determination of the weight to be accorded his appraisal.

36. After examining the testimony of the two experts, Mr. Horstman and Mr. Mitchell, the Court is convinced that Mr. Horstman is more credible and that he performed a more thorough analysis of the market and the Subject Property.

This Court concludes that Mr. Horstman's analysis and adjustment to the comparable sales is convincing and is supported by his treatment of the impact of the existing leases to CVS, Bank of America and Safeway. It is therefore entitled to greater weight than the analysis offered by the District's expert. Mr. Mitchell failed to give any consideration to the existing leases or their impact on the price a buyer would pay for the subject property on the value date. In addition, Mr. Mitchell gave far too much weight to the expression of interest of Fannie Mae in the project, thus, inflating his conclusion of value.

CONCLUSIONS OF LAW

I. Standard Of Review And Burden Of Proof.

This Court has jurisdiction over this appeal pursuant to D.C. Official Code § 47-3303. When a taxpayer appeals an assessment to this Court, the Court can affirm, cancel, reduce or increase the assessment. Id. As in all tax assessment appeals, this Court evaluates this case under de novo review. Square 345 Associates Ltd. Partners v. District of Columbia, 721 A. 2d 963 (D.C. 1998); Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. 1980). The Court's review is a two-step process. First, the Court must evaluate whether the assessment is incorrect or flawed. Safeway Stores Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987). The taxpayer bears the burden of proving that the assessments were incorrect or flawed. Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986).

If the Court determines that the assessment is incorrect or flawed, the trial proceeds to the second step in the process, evaluation of evidence as to the correct

market value for the Subject Property. At that stage, however, the taxpayer does not carry the burden of establishing the correct value of its property. Id.

Here, the Government agreed that Petitioner need not prove that its assessment was incorrect, an agreement which the Court views as a tacit admission that it was not correct. Therefore, at trial, Petitioner was not required to prove the incorrectness of the assessment, and the Court heard the parties' evidence as to the correct market value of the subject property. The Court was required to weigh all the evidence to determine which property valuation is the most credible.

The Court concludes that there is sufficient competent evidence on the record for the Court to determine the fair market value of the Subject Property. The Court finds that Petitioner's expert, Mr. Harry A. Horstman, III, MAI, was more credible than Respondent's expert. His testimony should be given greater weight as to the value of the Subject Property for Tax Year 2005. Upon review of the testimony and documentation presented, the Court concludes that Petitioner's expert properly analyzed the market data for the Subject Property and the impact of the existing leases, and he produced a logical and credible estimate of market value, \$47,700,000.

II. Valuation of Real Estate.

The purpose of the tax assessment is to establish an estimate of value on which real estate taxes can be based. The D.C. Official Code provides that the assessed value of real property, for taxation purposes, shall be the "estimated

market value” of the property on January 1st of the year preceding the Tax Year.

D.C. Official Code § 47-820(a)(3). Thus, the valuation date at issue in the instant appeal is January 1, 2004. “Estimated market value” is defined as:

100% of the most probable price at which a particular piece of real property, if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would be expected to transfer under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.

D.C. Official Code §47-802(4).

In other words, this Court must determine what would a buyer pay for the property as of the value date? In establishing that “estimated market value”, the District shall take into account,

all available information which may have a bearing on the market value of the real property, including, but not limited to, the following:

- (a) Government imposed restrictions;
- (b) Sales information for similar types of real property;
- (c) Mortgage or other financial considerations;
- (d) Replacement costs, less accrued depreciation because of age, condition, and other factors;
- (e) Income earning potential (if any);
- (f) Zoning;
- (g) The highest and best use to which the property can be put; and
- (h) The present use and condition of the property and its location.

9 DCMR § 307.1 (2008). All of these factors can be significant in valuing real estate.

There are three generally accepted approaches to the valuation of real estate. They are the comparable sales approach, cost approach and capitalization of income

approach. The applicable regulations describe each approach. 9 DCMR § 307 (1998). Although the assessor and appraiser must consider all three of these approaches, the assessor or appraiser may, in the exercise of discretion, ultimately rely on one method in determining a property's market value. Safeway Stores, Inc. v. District of Columbia, 525 A.2d at 209; 9 DCMR § 307.2. The District's expert and the taxpayer's expert each performed a comparable sales approach to value. Mr. Mitchell also did a form of income approach to value in his discounted cash flow analysis. Prior to applying one or more methods of valuation, the appraiser must make a determination of the highest and best use.

1. **Market/Sales Comparison Approach.** The "comparable sales" approach to valuation, also known as the "market" approach, attempts to determine value by studying the prices at which "reasonably comparable" properties have "recently" sold. Only arms-length transactions are to be used. Quantitative and qualitative adjustments are typically made to the sales (not the Subject Property) to try to account for differences between the sale properties and the property being valued.

The sales comparison approach is applicable when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market. The Appraisal of Real Estate at 419. In undertaking a market analysis, one must consider supply and demand relationships which provide information about trends and market anticipation. The Appraisal of Real Estate at 418. The appraiser must ensure that its data is market-oriented and reflects the motivations of a typical investor in the marketplace.

2. **Cost Approach.** The replacement cost approach attempts to value property based on the estimated cost to replace that property. First, the assessor or appraiser estimates the hard and soft costs to build a similar replacement, including at current costs for labor and materials. The estimated costs are then adjusted to take into account the amount of depreciation or loss of value attributable to the age and condition of the existing improvements, and any other pertinent factors which might have a bearing on value. This approach is useful in valuing new or relatively new buildings. The Appraisal of Real Estate at 354.

3. **Income Approach.** The capitalization of income approach to value is based, "upon the amount that investors would be willing to pay to receive the income that the property could be expected to yield." 9 DCMR § 307.5 (2008). Stated another way, the approach attempts to measure the present value of the future benefits of property ownership. A property's income streams and resale value upon reversion may be capitalized into a current lump-sum value. The Appraisal of Real Estate at 96. Thus, income divided by a capitalization rate equals value. And, given the same income, a higher capitalization rate will yield a lower value. The income approach is usually considered the most appropriate method for valuing large income-producing properties, such as office buildings, hotels, apartments and shopping centers.

When valuing land under the income approach, there are two types of procedures: direct capitalization and yield capitalization. These are generally not used as primary valuation techniques except in special situations such as subdivision analysis. Id. at 341. There are two types of direct capitalization

techniques including a land residual technique and ground rent capitalization. The yield capitalization technique is a discounted cash flow analysis or subdivision development analysis. Id. at 342. This analysis is appropriate when the highest and best use of the site is to be subdivided. A subdivision analysis is common in valuing residential subdivisions.

III. Conclusion

In this case, the evidence shows, and the Court finds, that the District's estimated market value was incorrect and that the assessment was flawed and erroneous. Petitioner has produced competent evidence of the estimated market value of its property by a well-qualified real estate appraiser. This case presents an instance, not uncommon to tax assessment appeals, in which there are two competing experts. As a result, the Court, in drawing its conclusions, must credit the testimony of one expert over that of the other. The law is clear that "[in] resolving factual issues presented by conflicting expert testimony, the trial court is in the best position to evaluate the experts' qualifications, demeanor, experience, reasoning, and testimony." Rock Creek Plaza, 466 A.2d at 859 (citing Designers of Georgetown v. E.C. Keys & Sons, 436 A.2d 1282, 1281 (D.C. 1981)).

In the instant case, there was a clear choice to be made and the better choice is to accept the opinion of Mr. Horstman, based upon his extensive experience, his more thorough analysis, his superior logic, and thoughtful consideration of the impact of the existing leases to CVS, Bank of America and more importantly, Safeway. In addition, Mr. Horstman conducted a thorough review of the office and residential markets for his highest and best use analysis. While he was aware of

Fannie Mae's expression of interest in the property, he concluded that a buyer would not consider a mere expression of interest in evaluating how much to pay for the Subject Property.

In appraising the property, Mr. Horstman was concerned with the estimated market value. Real property taxes are required to be based upon the estimated value of the property as of January 1, of the year preceding the Tax Year.

Estimated market value is defined in D.C. Official Code §47-802(4). Mr. Horstman considered the full value of this property consistent with the statutory definition.

The methodology and rationale of the Petitioner's expert are sound.

The Petitioner's expert, Mr. Horstman, used a more credible and reliable technique by first evaluating the highest and best use of the Subject Property. He performed a thorough analysis of the market including an inferred analysis of the office market and a fundamental analysis of the residential market, unlike Mr. Mitchell, who failed to perform similar market analysis. Mr. Horstman concluded that the highest and best use of the property was a medium-term hold, in other words, any buyer would hold the property and not begin development for approximately five years. Mr. Mitchell on the other hand, disregarded the market data and concluded that the highest and best use was to begin development immediately. Mr. Mitchell's analysis and conclusion of the highest and best use of the subject property were not credible.

The Court also finds that Mr. Horstman's comparable sales were properly adjusted to account for the differences from the Subject Property and its special circumstances as compared with the sales properties. This Court finds that it

cannot credit Mr. Mitchell's bulk comparable sales analysis for several reasons: 1) his failure to distinguish market conditions of the near Southwest submarket as compared with the Southwest market north of I-395 Southeast Southwest freeway, 2) his failure to consider the impact of the CVS and Bank of America leases, and 3) his failure to consider the impact that the Safeway lease would have on the price a buyer would pay for the Subject Property.

This Court also discredits Mr. Mitchell's discounted cash flow analysis because it was inappropriate to use it on these facts, as it was based on faulty assumptions. Discounted cash flow analysis or subdivision development analysis is only applicable where the highest and best use of the property is to subdivide it. The Subject Property had just received development approval as a single lot of record. Not only was the approach not applicable, but Mr. Mitchell employed assumptions that had no basis in the market or the facts of the Subject Property.

Thus, the Court concludes that the method of deriving value from the comparable sales method, as applied by Mr. Horstman, is a better and more reliable indicator of value than Mr. Mitchell's comparable sales approach. This Court also finds that Mr. Mitchell's discounted cash flow analysis was not applicable and thus discredits the valuation determined using that analysis. Accordingly, the Court having adopted Mr. Horstman's testimony, finds that the estimated market value and assessment for the Tax Year 2005, with a value date of January 1, 2004 is \$47,700,000.

It is therefore by the Court this 27th day of October 2008,

ORDERED, ADJUDGED and DECREED as follows:

1. That the estimated value for the subject real property as of January 1, 2004, is determined to be as follows: \$47,700,000 including \$44,700,000 for the land and \$3,000,000 for the improvements.
2. That the assessment records for the property maintained by the District shall be adjusted to reflect the value determined by this Order.
3. That Respondent, no later than November 3, 2008, submit to the Court for inclusion in the Court's Final Order the total amount of the refund due Petitioner based on this Court's finding of estimated value, including interest from the date of the filing of the petition.

SO ORDERED.



Rhonda Reid Winston
Associate Judge

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