

Opinion
No 1289

SUPERIOR COURT FOR THE DISTRICT OF COLUMBIA

TAX DIVISION

NEW YORK LIFE INSURANCE	*	
COMPANY, et al.,	*	
Petitioners	*	
	*	
v.	*	Tax Docket Nos. 3740-86
	*	3884-87
DISTRICT OF COLUMBIA,	*	
Respondent	*	

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND JUDGMENT

This case came on for trial upon petitioners' appeal from an assessment for real property taxes for tax years 1986 and 1987 and respondent's response thereto. Upon consideration of the evidence adduced at trial, and having resolved all questions of credibility, the Court makes the following:

Findings of Fact

1. Petitioner, New York Life Insurance Company ("NYLIC"), is a corporation organized and existing under the laws of New York with a principal place of business at 51 Madison Avenue, New York City in the State of New York. NYLIC is licensed to do business in the District of Columbia. NYLIC is the owner of the improvements on the subject property, Lot 46 in Square 250, in the District of Columbia, improved by premises known as 1333 H Street, N.W., and by agreement with petitioner George Washington University is obligated to pay all real estate taxes assessed against the subject property. Petitioner, George Washington University, is a private

institution organized and existing under the laws of the District of Columbia with a principal place of business at 800 21st Street, N.W., Washington, D.C. George Washington University is the owner of the subject property, Lot 46 in Square 250.

2. The respondent, District of Columbia, is a municipal corporation created by the United States Congress, Section 1-102 of the District of Columbia Code.

3. Petitioners received a notice of assessment dated February 27, 1985 stating that the assessment for tax year 1986 on Lot 46 in Square 250 improved by the premises known as 1333 H Street, N.W., was \$28,907,000. Petitioners received a notice of assessment for tax year 1987 for the subject property in the amount of \$34,573,000.

4. Appeals to the Board of Equalization and Review from the assessment for each year were timely filed. The Board of Equalization and Review reduced the assessment for tax year 1986 to a total of \$22,950,000. For tax year 1987, the Board reduced the assessment to \$28,992,305.

5. For tax year 1986, the land was assigned a value of \$9,706,737. The improvements were assigned a value of \$13,243,263. For tax year 1987, the Board of Equalization and Review allocated \$15,280,496 to the improvement and \$13,711,809 to the land.

6. For tax year 1986 taxes in the amount of \$465,885 have been paid in full. For tax year 1987, taxes in the amount of \$588,543.80 have been paid in full.

7. The subject property consists of a 12-story high-rise office building built in 1913 and remodeled in 1982-1983 and an 11-story office building built in about 1982. The buildings are located on the northeast corner of 14th and H Streets, N.W. A portion of the building, the Landmark Building, is a historic structure which had to be rehabilitated and retained in accordance with certain standards. Leasing in the building has been poor. About four floors remained a gutted shell as of a 1989 inspection by petitioners' appraiser. These floors were unoccupied. The location of the property in an area of porno establishments has been a hindrance to the commercial success of the property and development of the surrounding area. The building has three levels of underground parking with spaces for 245 cars. The main building has 213,409 square feet of net rentable area (211,019 for office space and 1,100 for retail). The Landmark portion of the building has a total of 34,615 square feet of net rentable area (32,395 for office and 2,223 for retail). These figures are derived from the lease rolls which reflect actual space, leased and vacant.

8. As of tax years 1986 and 1987, substantial rent and other concessions were being given office tenants. Such packages were necessary to attract tenants in a market in which there was an abundance of space available in the District and in northern Virginia. This trend in the rental market was expected to continue until at least after 1991 and 1992. These factors depress the income potential for the subject and other

properties. The range of discount for the subject property was between 10% and 12.3% in 1987 and 1988. The discount reflective of the market was about 15%.

9. The subject is somewhat over-improved for the surrounding neighborhood. The 1300 block of H Street is one of the worse blocks west of 13th Street in the downtown area. Therefore, it will not be able to achieve the rents it could if it were in a more desirable location.

10. Mr. William Harps appraised the subject property for tax years 1986 and 1987. Mr. Harps has been a member of the American Institute of Real Estate Appraisers since 1960. He has served as President of the national organization and of the local chapter. Mr. Harps is a member of the American Society of Real Estate Counselors and numerous other organizations associated with the field. He has qualified as an expert in the field in various courts. He has been an appraiser for many years.

11. Petitioner's expert considered and rejected for use in the appraisal for the subject the cost approach and the sales comparison approach. The cost approach was rejected. It is useful for new or nearly new improvements. The indication of value is derived by deducting from total production cost the amount of depreciation from all sources. The sales comparison approach requires a sufficient number of comparables. Additionally, it requires the availability of substantial economic data about the comparables which is often unavailable to an appraiser. The comparables used in such a study should

be similar geographically, physically and economically. Such reasons were among those resulting in the determination by the appraiser that the income approach to value is most appropriate for the subject. The primary reason that the appraiser found the income approach most appropriate is that the developer or buyer of income-producing property like the subject is most interested in the potential income and whether it is sufficient to pay the mortgage, expenses and a reasonable return on investment.

12. To arrive at an indication of value by the income approach, Mr. Harps examined the income and expense history for the property for five years between 1983 and 1987. He reviewed the rent rolls and leasing history for the building. The history and leasing problems for the subject led the appraiser to project that full occupancy would not occur until 1989. The substantial vacancy ratio after five years caused the appraiser to project a 7.5% stabilized vacancy ratio. (This factor is also responsible for a slightly upward adjustment of the capitalization rate discussed hereinafter.) Mr. Harps examined the costs of tenant improvements expended by the owners. It has been management's policy to expend what is necessary to lease the property. An allowance of \$6 to \$8 per square foot for excess tenant improvements over standard fit up was indicated. It was the appraiser's opinion that the need for these outlays would continue to be necessary to lease the remaining space in the building.

13. Certain errors were made by the owner in completing the income and expense forms submitted to the government. The statement dated March 24, 1986 (for calendar year 1985) notes incorrectly in item 1C that commercial net leasable space was 220,937. It should have been 3,323 square feet. At an average rental of \$13.75 per square foot, the rental income was \$45,691, changing the total income figure to \$4,882,900. As a result of the change, item 5 becomes \$5,209,368 and item 7 becomes \$2,066,065. The following expense changes are also indicated:

Item 12, Maintenance:	\$240,425 (instead of \$240,515)
Item 13, Miscellaneous:	\$1,113,615 (instead of \$1,113,575)
Item 14, Total:	\$1,972,415 (instead of \$1,972,465)

14. A number of corrections were noted by the appraiser which should be made to the rent rolls for calendar year 1985. These are listed in petitioners' exhibit #10 at pp. 53 and 54. After examining the rent rolls submitted to the District for the prior and subsequent year, Mr. Harps noted that corrections should be made to reflect accurately the leased space and rent received for it for 1986. These items appear in petitioners' exhibit #10 at pp. 55-56.

15. The leases in the subject provide for pass-throughs of operating expenses and real estate taxes in excess of the first year for all tenants except those renting storage areas. There are also consumer price index adjustments in the

leases ranging from 20% to as much as 100% of the increase. Expense for the subject for 1985 were about \$4.81 per square foot. The market data indicates median expenses of \$4.885. These figures justify the actual expenses for the subject. The appraiser used the actual expenses for the subject as adjusted, of \$1,185,997, in the income approach to value.

16. The 1986 expenses for the subject were found by the appraiser to be \$1,118,421 plus \$50,000 (the amortized portion of a large leasing commission) for 1986, \$163,582 increment for 1985 capital improvements and \$19,706 (1/20 of 1986 capital improvements) for \$1,351,709. Total expenses for the subject amounted to \$5.50 per square foot, while the range of the market was \$5.48 per square foot.

17. Since the rental history of the subject was so poor, the appraiser found it necessary to project income and expenses into the future to reach a year of stabilized income. It is necessary to project income to the point where the income is stabilized and vacancies are minimal in order that the investor can see the income to be received. After obtaining the stabilized figure from a future year, it must be discounted back at market oriented rates as the income is considered received in the earlier year. Petitioners' appraiser made this adjustment which seems appropriate. As of the end of 1987, there were a total of 19,813 square feet or 8.1% of the rentable space vacant in the subject. Considering the glut of office space, the overall vacancy rate and the fact that 1988 showed no improvement in the income picture, the appraiser

concluded that the income for 1987 should be used as stabilized income.

18. To determine the capitalization rate for the subject, Mr. Harps examined rates derived from the market. All of the sources examined pointed to a yield rate of 12% to 13.26% for January 1, 1985 and 10% to 11.4% for January 1986. Due to the problems with the buildings, as previously set forth, the upper range was deemed appropriate by the appraiser. (The higher the capitalization rate, the lower the value.) The comparative risk and lack of liquidity of a real estate investment suggests the requirement of higher yield rates than treasury bonds. After deriving the overall rates, the appraiser adjusted for the tax factor by 2.03%.

19. For valuation date January 1, 1987 the witness applied a capitalization rate of .1203 to a stabilized net operating income of \$3,161,632 to reach the sum of \$26,281,230. He discounted back as indicated above. After adjustments, the appraiser was of the opinion that the estimated market value for the property for tax year 1986 was \$19,875,000. For tax year 1987, valuation date of January 1, 1986, the appraiser used a capitalization rate of .1153 which he applied to the same stabilized net income to arrive at an indicated value of \$25,500,000. The expert accepted the land value as determined by the District for each tax year of \$9,706,737. The balance was allocated to the improvement in each case.

20. The building was sold to New York Life Insurance Company in April 1983 for \$19,029,920. Cash provided was

\$1,192,000, and notes were canceled for the remaining amount. This sale is not considered indicative of fair market value because the price was determined by the outstanding loan and a fee due to one seller who was construction manager for the property. The building was actually taken in lieu of foreclosure. The price is not representative of fair market value.

21. Troy Davis was the tax assessor for the subject property for tax years 1986 and 1987. He has been an assessor for ten years. Mr. Davis stated at trial that he used the mass appraisal approach, which encompasses the three recognized approaches to value to arrive at a value for the subject for the two tax years. The cost approach he addressed by analyzing the cost of a new building in the area. He also based his conclusions on the purchase price/^{of the} building in 1983. As noted earlier, the 1983 sale of the subject property was not an arms-length sale.

In the comparable sales approach, the assessor reviewed sales information for certain properties which he deemed to be comparable. He found most comparable a property located at 1444 I Street, N.W. He conceded that the property is only one-third as large as the subject. The property is located next to a metro station which enhances its value and appeal as a rental property. The building was vacant leaving it free to lease up at market rents, unlike the subject which had long-term leases at lower rents. Income and expense data was not available for the I Street property, therefore,

comparisons of financial data between the I Street property and the subject could not be made. Other properties identified by the assessor for comparison purposes were further downtown or in the K Street area. The location of these properties outside of the type of area where the subject is located (an area which offers sexually oriented entertainment) makes doubtful the comparability of the properties.

22. Employing the income approach to value, Mr. Davis looked at the owners' income and expense history, but he did not rely on it. He assumed that the income would improve. No reasonable basis was offered for the substantial projections made by the witness. The stabilized net income used by this witness in his calculation (\$4,374,056) was substantially in excess of the actual income experienced by the owner. The 1984 net income was shown at \$933,366. For tax year 1986, the assessor projected a stabilized net of \$3,908,848 for the subject. The actual gross income collected was reported at \$454,539 for the year reviewed (1983). The projections of the assessor regarding income are not supported by the evidence. At least for the near term the factors which were identified by petitioners' expert will suppress the anticipated income for this building. Thus, the assessor's stabilized projected income appears to be overstated and must be rejected.

The assessor applied an overall capitalization rate of .12168 for 1986 and .1265 for tax year 1987. The witness was instructed to use these capitalization rates by the Chief of Standards and Review. The source of these capitalization

rates was not explained by petitioner. The capitalization rates selected for the two years do not reflect the fact that interest rates were lower in 1986 than in 1985. Therefore, the capitalization rate should have been lower for 1986. The foregoing facts show substantial flaws in what the assessor said he did which would have resulted in erroneous assessments for each tax year.

23. It is not clear whether Mr. Davis actually utilized the mass appraisal technique for this property in his original assessments for tax years 1986 and 1987. The witness did admit that he was instructed by Mr. Klugel, the Chief of Standards and Review, to repeat the same assessment for 1986 which was used in 1985. Mr. Davis admitted that he followed that instruction. At least for 1986, the assessment was based upon the conclusion reached in 1985 by the District's assessor, i.e., \$28,907,000. With respect to tax year 1987, the witness apparently capitalized a projected income of \$4,374,056 to reach an estimate of fair market value of \$34,573,000.

$$\frac{\$4,374,056}{.1265} = \$34,577,517$$

The rounded figure arrived at by the capitalization of the income stream used by the witness is virtually identical to the value arrived at by the witness.

24. When Mr. Davis originally considered the value of the land component of the property, he thought that the FAR for the property was 8.5%. According to the witness, the FAR (floor area ratio) determines the gross area of a building

which can be put on the lot. The witness originally used 8.5% as the FAR in the calculation of the land value. He obtained \$349 per square foot. By substituting an FAR of 10, the result would be \$410 per square foot. This figure was arrived at by the following calculation:

$$\begin{array}{ccccccc} \text{Locational} & \times & \text{corner} & & \times & \text{assembly} & \times \text{ FAR} = \text{Land} \\ \text{Rate} & & \text{adjustment} & & & \text{adjustment} & \text{Value} \end{array}$$

or

$$\$30 \quad \times \quad \$1.10 \quad \times \quad \$1.25 \quad \times \quad 10 = \$412.00$$

The \$412 was apparently rounded downward to \$410. Multiplying the number of square feet of land by \$410 results in \$11,403,333. The latter figure respondent seeks to add to the original building assessment for tax year 1986 to increase the total value to \$30,603,593. No change is proposed in the value of the improvement. A similar recalculation is proposed for tax year 1987.

The foregoing calculation purports to reflect the cost approach to value. However, that approach requires an estimation of the land at its highest and best use, plus cost to produce the subject, including improvements and entrepreneurial profits taking into account depreciation from all sources. The addition of the land value at highest and best use to the sales price as done here is not an appropriate way to do the cost approach. Results obtained by this ^{method} are flawed.

Conclusions of Law

In appealing from assessments of real property for tax purposes, the tax payer has the burden of proving that the assessment was incorrect or flawed. Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986). The petitioners are not required to establish the correct value of their property. Id.

The assessments for the tax years in question made by the District were erroneous and flawed in a number of respects. To the extent that the income approach to value was employed in the two tax years, the projections of income utilized in the calculation was not based on actual experience or reasonable projections in light of specific factors relating to the subject property. The income approach to value requires a determination of a stabilized annual net income by reference to the income and expenses for the property over a period of years. District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 115 (D.C. 1985); Rock Creek Plaza-Woodner, Ltd. v. District of Columbia, 466 A.2d 857, 858 (1983). The assessor for this property gave little or no consideration to the actual history of the property. While experience was limited at the time of the assessments, there was data from which reasonable projections could be made based on past history of income and expenses and reasonable adjustments for future income.

Once a stabilized annual income is determined, it must be divided by a capitalization rate in order to determine an indication of value. Rock Creek Plaza-Woodner, Ltd. v.

District of Columbia, 466 A.2d at 858. The capitalization rate represents the amount that must be earned annually in order to pay the mortgage, expenses and a fair return on equity and the property taxes. Id. The capitalization rate used by the assessor in this case was provided him by other members in his department. Its origin could not be determined from the evidence. There is no showing that it was derived from financial and economic information available in the market place. When the figures derived by the assessor were tested, they produced a substantial negative cash flow.

By not giving appropriate consideration to a major component of the income approach, the capitalization rate, the assessor committed a major error. It was also shown that the capitalization rate for the two years involved should have been different. The assessor used the same capitalization rate each year in spite of market data to the contrary. His calculations, therefore, are highly suspect. While there was some question as to the actual method used by the assessor, since he had given inconsistent versions of his methodology, it appears that he did in fact rely upon the income approach to some extent. The improper projection of the stabilized income and capitalization rate of doubtful derivation make the calculation unreliable.

For tax year 1986, the assessor simply repeated the assessment made by the Chief of Standards and Review for the prior year. The prior assessment had been reduced by the Board of Equalization and Review on appeal. An assessment made by

the Board of Equalization and Review becomes the basis for taxation until a subsequent reassessment made according to law has been determined. District of Columbia v. Burlington Apartment, 375 A.2d 1052, 1056 (D.C. 1977). Following an invalid assessment, the law requires the District to make a new one. See Brisker v. District of Columbia, 510 A.2d 1037, 1040 (D.C. 1986). While an assessor may consider the prior assessment, he must make a new valuation. Id. The assessor may consider information forming a part of the prior assessment in making his new valuation. Id. at 1040-1041. In this case, it does not appear that the assessor made a new valuation for tax year 1987. Rather, he accepted the prior figure and attempted to find justification for it.

The District's assessor relied heavily upon the 1983 "sale" of the improvement of this property. In fact, a prior arm's-length sale is viewed as evidence of the highest rank of value of a property by many courts. District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 116 (D.C. 1985). In this jurisdiction, it has been held that even an owner's asking price for real property is probative of fair market value. District of Columbia v. Burlington Apartment, 375 A.2d 1053, 1054 (D.C. 1977) (en banc). Evidence of a recent sale is competent so long as it does not result from foreclosure or other legal compulsion. See District of Columbia v. Burlington Apartment, 375 A.2d at 1055, n.6. (citations omitted). The evidence in this case supports the finding that the sale in this case was not an arm's-length sale. Rather it was made in

lieu of foreclosure. A part of the price included fees due the construction manager. While the District may not have been aware of all of the circumstances surrounding the sale, the evidence supports that this is not the type of sale for which this court can view as evidence of the highest rank in estimating the value of the property. A valuation based upon this sale, is erroneous. All of the foregoing factors demonstrate that petitioners have met their burden of showing that the assessment for the tax years in question were erroneous and flawed.

In this trial de novo, respondent asserts that the valuation previously given by it is also erroneous. The assessor contends that he used the wrong FAR in making his calculations of the land value. Instead of 10, he used 8.5. The petitioners' expert considered and found an FAR of 9.74%. The error was made by a draftsman. It is not clear from the evidence for whom this draftsman worked. In any event, the assessor knew of his own personal knowledge that the building was on a street which would allow ten stories. Thus, he was aware of information, at the time of the original assessment, that should have led him to conclude that the FAR was in error. Recalculating based on the claimed error, the assessor now seeks to reassess the property at a higher value.

The trial court does have authority to increase an assessment above the amount approved by the Board of Equalization and Review. Rock Creek Plaza-Woodner, Ltd. v. District of Columbia, 466 A.2d 857, 859, n.1 (D.C. 1983). It

is a general rule that once property has been assessed, it cannot be reassessed, simply because there was a lack of information or an error of judgment based on quantity, quality or value of the property assessed. 1111 Nineteenth Street Associates v. District of Columbia, 521 A.2d 260, 261 (D.C. 1987) and Hunt v. District of Columbia, 71 App.D.C. 143, 146, 108 F.2d at 13 (1939). In light of this principle, it would seem that the District would be precluded from reassessing property solely to correct an error, many years after the assessment, particularly where, as here, the District was aware of information from which it could determine the characteristics of the property to be valued. This is not a case where it has been demonstrated that false information was provided to the District by the tax payer. Moreover, the assessor candidly admitted knowledge of the information necessary to make the calculations invalid. The FAR is apparently based upon the width of streets. This information was available to the District of Columbia. Where information pertaining to property is filed with the District of Columbia, the Mayor and his subordinates, including tax assessors, are put on notice of such information. 1827 M Street v. District of Columbia, 537 A.2d 1078, 1083 (D.C. 1988). While the Court may cancel, raise or reduce an assessment, the tax assessors are precluded from reassessing properties. Under the circumstances of this case, they are not permitted to do so.

In this case, the petitioners have shown not only that the assessments made by the District were flawed and

erroneous, but they have produced competent evidence of the actual value of their property by a well-qualified real estate appraiser. There is no basis to disbelieve the expert's testimony in this case. Therefore, it will be accepted. See Rock Creek Plaza-Woodner, Ltd. v. District of Columbia, 466 A.2d 857, 859 (D.C. 1983). The appraiser valued the subject property for both tax years using the income approach to value. This is one of three recognized approaches to value. District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 113 (D.C. 1985). This approach takes into account the various factors mandated by D.C. Code § 47-820 (a) (1981). In appraising the property, the appraiser was concerned with the actual estimated 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. Code § 47-802 (4) (1981). The appraiser considered the full value of this property consistent with the statutory definition. The appraiser did not consider significant that the ground is owned by one party and the improvement by another. Any willing buyer necessarily would have to purchase the building with the ground lease, as the improvement is of no use sold separately. An examination of the whole property value is consistent with the statutory definition as well. Insofar as the incorrect FAR is concerned, Mr. Harps took that matter into account in his appraisal of the property. He found no significant impact made by the alteration of the FAR.

As required, the appraiser considered and rejected the other two approaches to value. While the building was of recent vintage, it had sufficient income history to allow for meaningful projections of value by the expert. Although all three approaches to value must be considered, one may be relied upon, provided the others have been considered and there is a reasonable basis for selecting one over the other. Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 209 (D.C. 1987). The reasons given for the selection of the income method of valuation over the others by the witness is persuasive. The witness considered the rental history for the property and made reasonable projections about the future based upon the property's performance. He also obtained his capitalization factor by a careful examination of financial and market indicators. He made adjustments where appropriate and arrived at a value. The methodology and rationale of the expert appear to be sound in this case.

Having no quarrel with the District's original allocation of land value, he accepted the allocations as made by the District. Mr. Harps accepted the District's valuation as supported by the other evidence that he examined. For tax year 1986, the total valuation as of the valuation date of January 1, 1985 was \$19,875,000 with \$10,168,263 allocated to the improvement and \$9,706,730 allocated to the land. For tax year 1987, with a valuation date of January 1, 1986, the appraiser found a total valuation indicated by his methodology

of \$25,500,000 with \$9,706,737 allocated to the land and \$15,793,263 allocated to the improvement.

Having accepted the findings of value as determined by the petitioners' appraiser, the Court must reduce the assessment in accordance therewith.

For the foregoing reasons, it is by the Court, this 19th day of July, 1990,

ORDERED, ADJUDGED AND DECREED as follows:

1. That the estimated market value of the subject property was \$19,875,000 for tax year 1986, of which \$9,706,737 is attributed to the land component and the remainder to the improvement.

2. That the estimated market value of the subject real property for the valuation date for tax year 1987 is \$25,500,000 with \$9,706,730 allocated to the land and the balance allocated to the improvement.

3. That the assessment record cards for the property maintained by the District of Columbia shall be adjusted to reflect the values determined by the Court in this order.

4. That the respondent shall refund to petitioners any excess taxes collected for tax years 1986 and 1987 resulting from assessed values used as the basis for such taxes which exceed those determined by this order.

5. That the entry of decision shall be withheld pending submission of a proposed order under the provisions of Super. Ct. Tax R. 15.

6. That the matter shall be set for a status hearing on July 13, 1990 at 9:30 a.m., unless prior to that date an order submitted pursuant to Rule 15 has been approved.

Jimmie Wagner

J U D G E

Signed In Chambers

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A TRUE COPY

TEST:

Clerk, Superior
the District of Columbia

By

Claudette F. Hooker

Deputy Clerk

Deputy Clerk