

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

Tax Division

FILED

JUL 10 1990

SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

W.T. GALLIHER & BRO.,
INCORPORATED,
Petitioner,

v.

Tax Docket No. 3903-87

DISTRICT OF COLUMBIA,

Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This matter came before the Court for trial upon the petition of W.T. Galliher & Bro., Incorporated, in which it appeals from a real property tax assessment for tax year 1987 and seeks a partial refund of taxes paid. Respondent filed an answer denying petitioner's entitlement to the relief sought. Upon consideration of the petition and response and evidence adduced at the hearing, and having resolved all questions of credibility, the Court makes the following:

FINDINGS OF FACT

1. Petitioner, W.T. Galliher & Bro., Inc., a District of Columbia Corporation, is legally obligated to pay all real estate taxes against Lot 75 in Square 116. Petitioner is owner of the land and improvements thereon known as 1920 N Street, N.W., situate in the District of Columbia.

2. The tax in controversy is a real estate tax for tax year 1987 assessed against said Lot 75, Square 116, and improved by a building known as 1920 N Street, N.W., in the District of

*opinion
No
1290*

Columbia. The tax in controversy is based upon a total assessed value of \$21,700,000.

3. Petitioner timely filed an appeal with the Board of Equalization and Review, which sustained the proposed assessment. The taxes in the amount of \$440,510 were timely paid.

4. The subject property consists of an eight-story office building with two basement garage levels, located on a lot of approximately 19,832 square feet with frontage of approximately 207.6 feet on the south side of N Street, N.W. Access to the subject property is limited to one-way streets, in contrast to locations on major two-direction thoroughfares more common to downtown office buildings. The subject was built in 1980 and contains approximately 113,175 square feet of office space and a floor are ratio (FAR) of 6.0. The subject contains 161 parking spaces, and is an all-electric building located in an SP-2 zone. The SP-zoning classification is located on the periphery of the more densely-zoned central business district and the adjacent residential zones. SP-2 zoning is more restrictive than commercial zoning and limits tenancies generally to professional, eleemosynary, and non-profit groups, and prohibits leasing for retail use, for general commercial office use, or for use by a government tenant such as the General Services Administration or the District of Columbia government. Finally, the SP-2 zoning classification allows a nonresidential FAR of 3.5. Thus, the subject property's 6.0 FAR renders it a nonconforming structure requiring Board Zoning

Adjustment approval of any addition, modification, or reconstruction.

5. Mr. William S. Harps testified as petitioner's expert appraisal witness. Mr. Harps, who has been an appraiser in the Washington area for more than thirty-five years, is also a past local and national president of the American Institute of Real Estate Appraisers, and of the Washington Board of Realtors. Mr. Harps has served as a member of the Board of Equalization and Review, as well as the Board of Zoning and Adjustment in the District. He has appraised some 200 to 250 commercial office buildings in the District, some of them on more than one occasion, and has specialized in the appraisal of downtown commercial properties for the past 12 to 15 years. Finally, Mr. Harps has presented expert valuation testimony on behalf of both private parties and government agencies, and has previously been qualified as an expert in this Court. Respondent stipulated to Mr. Harp's expert qualifications.

6. Mr. Harps testified that the capitalization of income approach is the proper approach to use in valuing income-producing properties because investors and lenders are interested primarily in the ability of a property to generate sufficient income to carry its debt service and provide a sufficient return on investment. Respondent's witness, Mr. Appelbaum, the assessor responsible for the assessment of the subject property for tax year 1987, agreed that the income approach was the most proper methodology for valuing office buildings in the District of Columbia. Both Mr. Harps and Mr.

Appelbaum considered the comparable sales (or "market data") approach and the cost approach. Mr. Harps did not consider the cost approach to be valid for appraising the subject property because the income approach is relied upon by buyers in valuing buildings such as the subject, and the cost approach is most useful in valuing new or nearly new buildings. Mr. Appelbaum agreed with the latter position and rejected the cost approach. Neither appraiser did an analysis that arrived at an independent value using the market data approach or comparable sales approach. Mr. Harps did not undertake a sales comparison approach because of the absence of the sales of properties susceptible of meaningful comparison. The subject has an SP-2 zoning unlike many other office buildings which sold. The market data approach is useful if there are a sufficient number of comparable sales to create defined value patterns in the market. Such transactions were absent in this case. Comparability turns on a number of characteristics of the property beyond merely the price per square foot for which it sold. Comparisons must be made between the various properties' location, size, land area, use income, expenses, vacancy rates, and general rentability. Under the circumstances, the rejection of this method of valuation was reasonable. Mr. Harps relied on the income approach to value which he deems most reliable.

7. Before appraising the subject property, Mr. Harps undertook a thorough on-site examination of the property. This detailed investigation revealed that the property was in poor physical condition for a building only eight years old. Mr.

Harps indicated that both the roof and the rear wall had leaked, that the roof had undergone substantial repairs during 1986, but that on the date of valuation some repairs remained to be done. As a result of his inspection, Mr. Harps concluded that the subject property was constructed of good materials, but it suffered from poor workmanship in its construction.

8. The capitalization of income approach requires that the net operating income of the property (gross income minus expenses and vacancy and credit losses, if any) be divided by a capitalization rate (a percentage figure reflecting an acceptable return on investment as well as the appropriate real property tax rate) to yield an estimate of market value. Because the capitalization rate is divided into net operating income, the larger the capitalization rate used, the lower will be the resulting property value. In reaching his estimate of value, Mr. Harps employed a capitalization rate of .1153 (or 11.53%), while Mr. Appelbaum used .1192 (or 11.92%). Mr Harps' capitalization rate, because it was slightly lower, would yield a slightly higher total value than the rate used by Mr. Appelbaum, if applied to the same net operating income.

9. In his income analysis, Mr. Harps utilized the actual net operating income achieved by the subject property during calendar year 1986, as reported by petitioner to the District of Columbia Department of Finance and Revenue on its income and expense form and leasing report. Before employing actual rents, however, Mr. Harps surveyed rental rates and leasing practices in the market to assure that the rents actually being

achieved by the subject property were in accordance with the rates being paid for similar space.

10. During the time relevant to the valuation and from 1983, the practice of granting tenant concessions was pervasive in the competitive Washington office rental market, generally in the form of free rent and above standard improvements to tenant space. This practice reduced the net effective rent being received by the property owner as indicated by the "face rate" of the lease. Mr. Harps surveyed nine office buildings in the same general area as the subject and found that, on a percentage basis, the tenant concession packages being offered on leases in those buildings represented discounts from the face rates of the leases from 10 percent to 25 percent. Mr. Harps estimated the typical concession being offered in the marketplace as of a January 1, 1986, to be 15 percent. He then surveyed "asking" rents in the market, and he found asking rents in the 23 buildings surveyed ranged from \$16.50 to \$28.00 per square foot. The leasing agents with whom he had spoken indicated that all of the asking rents were negotiable. The average asking rent, before accounting for tenant concession packages, was \$23.03. Applying the 15% discount represented by an average tenant concession package to these asking rents, Mr. Harps concluded that the most likely net effective rents for the 23 buildings surveyed (those falling within one standard deviation of the average) would range from \$17.45 to \$21.70 per square foot.

11. Mr. Harps calculated "net effective rents" by

subtracting the total value of the tenant concessions (in the form of rent abatements and tenant improvements paid for by the landlord) from the total rent to be received over the term of the lease, and then dividing the resulting net income figure by the term of the lease.

12. Mr. Harps verified this range of net effective rents by analyzing seven actual leases signed in December of 1985 for space in nearby office buildings. In the expert's opinion it is important to make adjustments when relying on rental data from comparable properties such as these seven to estimate the income and value of the subject property. Specifically, adjustments must be made for differences in condition, location, zoning, and age of the building. Therefore, Mr. Harps adjusted the face rates of those leases to reflect tenant concessions, and made the adjustments for condition, age, and zoning which were necessary to make the leases considered comparable to those in the subject property. This analysis indicated that fair rents at the subject property would be expected to fall within the range of \$17.00 to \$22.31 per square foot.

13. Mr. Harps also reviewed the leases signed at the subject property since the date of valuation. The leases were signed in 1987 and 1988 at net effective rates, after accounting for actual tenant concessions, of \$20.70 and \$21.92 per square foot. The rents obtained for new leases are better indicators of market rents than rental information from other buildings. Mr. Harps concluded that the \$21.92 per square foot rate

actually achieved at the subject property in 1988 represented the approximate upper limit of what could reasonably be attributed to the property on a per square foot basis for tax year 1987. The asking rents at the subject property in December, 1985, were approximately \$20.00 per square foot.

14. Having established a range of market rental rates, Mr. Harps reviewed the actual leases on the subject property as of the end of 1985. No leases were scheduled to expire in 1986, therefore, Mr. Harps estimated 1986 office income by projecting a range of increases in the consumer price index and the timing of pass-through payments, which indicated a range of probable 1986 office income from \$2,360,989 to \$2,446,017, exclusive of parking. These estimated incomes were so close to the actual 1986 office income, Mr. Harps chose to rely on the actual income of the subject property in this income analysis. The actual income on the subject property represents a fair economic rent as of January 1, 1986.

15. Mr. Harps considered next the economic expenses attributable to the subject property. Mr. Harps tested the expenses for the subject property against those in this study. The actual expense rate for the subject property, \$5.48 per square foot, was within the range of expense rates indicated by the survey of office building expense rates. Although the actual expenses appeared to be on the low side to petitioner's expert, considering the physical condition and poor workmanship revealed upon inspection, Mr. Harps decided to use the actual expense rate in his income capitalization analysis. This

appears to be a reasonable, although a conservative estimate, for utilization in the income capitalization approach.

16. Mr. Harps explained his derivation of an appropriate capitalization rate. By various methods of calculation, Mr. Harps developed a range of the appropriate capitalization rates to be applied to the subject property. He considered various economic indicators. In Mr. Harps' opinion, the lower of the rates indicated was warranted. The tax factor was added back in to obtain 11.53%.

17. Mr. Harps then subtracted the actual 1986 operating expenses (\$619,901) from actual 1986 income (\$2,603,104) inclusive of parking, to arrive at the actual 1986 net operating income of \$1,983,203. Dividing this actual income by the capitalization rate, it was Mr. Harps' opinion that, as of January 1, 1986, the subject property had an estimated market value of approximately \$17,200,000.

18. Mr. Harps performed an equalization study of the subject property. In this study, he compared the assessment on the subject property to the assessment on 1300 19th Street, N.W., a property across the street from the subject. Both Mr. Harps and respondent's witness Mr. Appelbaum testified that the subject property and 1300 19th Street were very similar and could be expected to command approximately the same rents. Both the subject and 1300 19th Street are zoned SP-2, and 1300 19th Street is the only other office building in this vicinity with the same zoning as the subject. There are physical

similarities in the two buildings. The building is only two years older than the subject, but the subject's inferior location offsets this fact. The property at 1300 19th Street has a more advantageous corner. Thus, the window space is greater making the space more attractive to tenants. The subject is located on an interior lot, an inferior position. The subject contains 113,175 square feet of net rentable area, while 1300 19th Street contains 118,049 square feet of net rentable area.

The subject property was assessed for approximately \$192 per square foot of net rentable area, while 1300 19th Street was assessed at approximately \$153 per square foot of net rentable area. Mr. Harps indicated that it was his opinion that 1300 19th Street was a slightly more valuable property based on its corner location, better access, and better physical condition. Based on the similarities between the two properties, both should have been assessed at approximately the same rate per square foot. Mr. Harps multiplied the net rentable area of the subject by the rate of \$153.05 per square foot at which 1300 19th Street was assessed. He found that equalizing the two properties' assessments resulted in a value for the subject of \$17,321,433. Mr. Harps concluded that the equalization analysis validated his market value of \$17,200,000. Assessing the subject at that value would place it back in equalization with the very similar property directly across the street.

19. Mr. Phillip Appelbaum, the assessor responsible for the tax year 1987 assessment of the subject property, testified as

respondent's witness. Mr. Appelbaum testified that 1987 was the first year in which he was solely responsible for assessments in the area of the subject property. For tax year 1987, Mr. Appelbaum assessed about 500 properties. He admitted candidly that he made some errors. He also admitted that the value attributed to petitioner's building was high or excessive.

20. Mr. Appelbaum did not conduct an inspection of the property. He "walked by". He was unaware of the subject's physical deficiencies, although he stated that knowledge of these problems would not have altered his assessment of the subject property.

21. Mr. Appelbaum testified that the capitalization of income approach was the proper and accepted methodology for valuing income-producing properties. Although he was aware at the time he did the assessment in question of the actual income and expenses reported by petitioner, he rejected the actual net income reported for the subject property and substituted in its place a net income of \$2,587,699.

22. Mr. Appelbaum imputed an economic rent of \$29.00 per square foot to the net rentable area of the subject. He arrived at \$29.00 as "economic rent" as the result of a study he had compiled of thirteen buildings. Three properties in the study had not filed income and expense forms. Therefore, leasing information for those properties was unavailable. In addition, one of the buildings was entirely occupied by a

single tenant. Another had only two tenants and was 78% vacant. Among other data, the study indicated the range of rents being received in each property, an average of the face rents of the leases on the property, and rates reflected in "new" leases. The assessor's study lists the following as the face rates of "new" office leases for those properties where such information was available:

\$15.00
28.06
20.00
31.62
24.92
33.07

The average face rate of these leases was \$24.12. The average of the "new" rental rates is \$25.45. The assessor decided, however, to apply a rate of \$29.00 to the subject property without any sound supporting reasons.

23. The assessor indicated that he believed that all of the properties in his study, with the exception of the subject were commercially zoned. By definition they were more advantageously located than the subject, which is zoned SP-2. Mr. Appelbaum made no adjustment to compensate for the fact that the subject property was the only SP-zoned property in the study. None of the buildings in his study were older than the subject. In deriving "economic rent," Mr. Appelbaum made no adjustment to the rental rates for age, zoning, physical condition, location or access. He did not adjust the rents of any of the other buildings in his study for such factors as tenant concessions and rent abatements, better access, better

zoning, better location, or better physical condition of the comparable properties. He had no evidence of any SP-zoned buildings renting for \$29.00 per square foot. The \$29.00 "economic rent" he employed did not account for any of the rent abatements or other tenant concessions. Mr. Appelbaum broke down the reported income and expense information for buildings in his area by decade, selecting therefrom a rent that he felt represented the typical "economic rent" per square foot to be attributed to all buildings constructed prior to 1960, those built between 1960 and 1970, those from 1970 to 1980, and those built after 1980. He made no adjustments, other than the groupings by decade. No adjustments were made for buildings, such as the subject, which were nonconforming structures, or were located on interior (rather than corner) lots.

25. As a result of substituting \$29.00 per square foot "economic rent" for the actual rents being received for the subject (the highest lease rate ever achieved for the subject property being approximately \$22.00 per square foot), the assessor substituted a net operating income of \$2,587,699 for the actual net income of \$1,983,203. Dividing this "economic" net operating income by his capitalization rate of .1192, the assessor concluded that the subject property had a value of approximately \$21,700,000. If Mr. Appelbaum had applied the same income approach that he employed in doing the assessment of the subject property and substituted \$22.00 rent per square foot for economic rent, he would have developed an assessed value for the property of \$15,406,174.

26. Mr. Appelbaum had also been responsible for the tax year

1987 assessment placed on the property known as 1300 19th Street, the property located across the street from the subject and used by Mr. Harps as a comparable property in his equalization study. The assessor acknowledged that the two properties were very similar, and characterized the differential in assessments between the two in 1987 as "perhaps excessive" and "a large magnitude difference" for similar buildings. He went on to indicate he had not done an equalization study that year. He admitted that the disparity in assessments had resulted from the methodology he had employed in his first year of sole responsibility for these assessments, and he has altered that methodology.

27. The estimate of value of the subject property as of the valuation date, January 1, 1986, determined by petitioner's expert is supported by a preponderance of the evidence. Petitioner's expert witness did not allocate the total value between land and improvement. The District's assessor did not explain his allocation or calculation of the land component for the property. Respondent valued the land at \$8,626,920 in its assessment for 1987 which represents about 40% of the total value of the assessment made by the District that year. For tax year 1985 and 1986, the land was assessed at \$5,751,280. In each of those years the land component represented approximately 38% of value. The land area is 19,832 square feet (rounded). The land area work sheets used by the District for the year 1987 for petitioner's building does not reflect how the District calculated the land value for this property. The land value proposed by the District would be \$435 per

square foot of land area, while it was valued at \$290 per square foot in tax years 1985 and 1986. Petitioner's expert determined the value of the property as a whole.

CONCLUSIONS OF LAW

This Court has jurisdiction over this appeal pursuant to D.C. Code §§ 47-825 and 47-3303 (1981). The Superior Court's review of a tax assessment is de novo, which necessitates competent evidence to prove the issues. Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. App. 1980). Petitioner bears the burden of proving that the assessment appealed from is incorrect. Brisker v. District of Columbia, 510 A.2d 1037 (D.C. App. 1986). Petitioner can meet this burden by demonstrating that the valuation of the subject property was flawed. Id. Petitioner has met that burden in this case.

The assessor conceded that he made certain errors in assessing the property and that the assessment was excessive. He rejected the actual net income reported for the subject property and substituted a figure not supported by the evidence. He failed to consider adequately, or at all, factors bearing on values as set forth in D.C. Code § 47-820 (a) (1981). Additionally, petitioner has proven by a preponderance of the evidence that the estimated market value for the subject property on the valuation date for tax year 1987 was well below the value determined by the District. The assessment made by the District for tax year 1987 for petitioner's property was flawed and incorrect.

There are three recognized approaches to value which assessors may apply: replacement cost, comparable sales and income method of valuation. 16 DCRR § 108 (b), (9) DCMR § 307.5; District of Columbia v. Washington Shearton Corp., 499 A.2d 109, 113 (D.C. 1985). The statutory requirement that appraisers take into account evidence relating to each approach requires that all three approaches be considered. Safeway Stores, Inc. v. District of Columbia, 525 a.2d 207, 209 (D.C. 1987). One approach may be used provided the others have been considered, and the assessor has a reasonable basis for selecting one over the other. Id.

Petitioner's expert witness considered and rejected two of the approaches to value for the subject, the cost approach and the comparable sales approach. The reasons given by the witness for the inapplicability of these two approaches were reasonable. Of the three recognized approaches to property valuation, the income approach is the most appropriate to be utilized in valuing income-producing properties. 1015 15th Street, N.W., Associates Limited Partnership v. District of Columbia, Tax Docket No. 3266-83, slip op. at 7 (Sup. Ct. November 13, 1984); The Washington Sheraton v. District of Columbia, 111 Wash. L. Rptr. 1053, 1059-61 (Sup. Ct. 1983). Witnesses for both respondent and petitioner agreed that the capitalization of net income of the subject property was the proper method of estimating the subject property's market value. Petitioner's expert relied upon the income approach to value. The capitalization of income approach requires that stabilized annual net income (determined by reference to the

actual income and expense pattern generated by the property over a number of years) be divided by a capitalization rate reflecting the rate the taxpayer must recover annually to pay the mortgage, to obtain fair return equity, and to pay real estate taxes. Rock Creek Plaza - Woodner Ltd. Partnership v. District of Columbia, 466 A.2d 857 (D.C. 1983).

In appraising the subject property, petitioner's expert witness investigated the actual income and expenses generated by the subject property. He found them to reflect a stable income pattern at the subject property, and supported by comparable market rents properly adjusted. Therefore, he relied on the actuals in his calculation of value.

Petitioner's expert's capitalization rate was derived by appropriate consideration of economic and financial data. The result was a more conservative indication of value than the capitalization rate suggested by respondent's witness.

Petitioner's expert gave persuasive testimony as to the market value of the subject property calculated by the capitalization of income approach. The preponderance of the evidence shows that the fair market value of the property on the valuation date was \$17,200,000 as determined by petitioner's expert witness.

The law requires the Mayor to assess real property, "identifying separately the value of the land and improvements thereon." D.C. Code § 47-821 (a) (1981). The Mayor is also required to compile a preliminary assessment roll identifying each property and specifying certain information related

thereto, including the value of the land and improvements. D.C. Code § 47-823 (a) (1). In this jurisdiction, these provisions have been interpreted to require that land and improvements thereon be assessed separately. 1111 - 19th Street v. District of Columbia, 521 A.2d 260, 270 (D.C. 1987). The tax levy each year is made upon the "real property." D.C. Code § 47-811. The assessed value of real property is its estimated market value as of the valuation date. D.C. Code § 47-820 (a). "Real property" is defined in the Code as real estate identified according to lot and square together with any improvements thereon. D.C. Code § 47-802 (1) (1982). Thus, taxes are imposed on the estimated market value of the whole.

Petitioner's expert made no allocation between the land and improvements. He provided an estimated market value for the real property together with the improvements. The value as established by the evidence cannot be rejected solely because its proponent did not allocate between land and improvements. Petitioner is required to pay taxes on no more than the estimated value of the real estate together with any improvements. D.C. Code §§ 47-811, -820 (a). He cannot be obligated to pay more simply because he has not proposed an allocation between land and improvements. Moreover, petitioner is not required to establish the correct value of its property. Brisker v. District of Columbia, 510 A.2d at 1039. The taxpayer is only required to show that the assessment is incorrect. Id. Not only did the taxpayer meet that burden, it also established the estimated market value of the property as defined by law. Having met that burden, petitioner should not

be denied relief because the allocation of the total value between land and improvements was not shown by its witness.

See In Re Appeals of Kent 2124 Atlantic Avenue, Inc, 166 A.2d 763, 770 (N.J. 1961).

An allocation between land and improvements can be calculated reasonably from other evidence in the record and the actual estimated market value. An allocation in the same proportion of land to total value as made by the assessor would result in a land value of \$6,800,000. Deducting the land value from the total estimated value leaves a residual of \$10,320,000 attributable to the building only. The percentage of the value of land and improvements to the whole as proposed by the assessor is retained by this allocation. The percentage of land value to the whole is also within two percentage points of the ratio of land to total value for the two prior tax years. Relief should not be denied because mathematical precision in valuation is not obtained. McCeney v. District of Columbia, 97 U.S. App. D.C. 282, 286 (1956); In Re Appeals of Kents 2124 Atlantic Avenue, Inc., 166 A.2d at 769. Therefore, allocation will be made as described.

It is therefore by this court the 9th day of July, 1990,

ORDERED, that the assessed value for the petitioner's property for tax year 1987 is determined to be as follows:

Land	\$ 6,880,000
Improvements	<u>10,320,000</u>
Total Assessments	\$17,200,000

It is further

ORDERED, that the petitioner shall submit to the Court a proposed order for an adjustment in the assessment records and a refund for the overpayment of taxes due to the petitioner (and interest as allowed by law) consistent with this Order. A copy of the proposed order shall be served on respondent. It is further

ORDERED, that the parties shall appear before the Court on the 19th day of July, 1990, at 9:30 a.m., to present the Order and/or for status hearing, unless prior to that date an unopposed Order has been submitted to the Court.



J U D G E

Signed in Chambers

Copies mailed this 11th day of July, 1990, to each of the following:

Charles Camalier, III, Esquire
Stanley J. Fineman, Esquire
1666 K Street, N.W.
Suite 1100
Washington, D.C. 20006

Nicholas Majett, Esquire
Assistant Corporation Counsel
1133 North Capitol Street, N.E.
Room 238
Washington, D.C. 20002

Harold L. Thomas, Director
Department of Finance and Revenue

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