

Opinion # 1283

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA **FILED**

TAX DIVISION

JUN 22 1990

WILLIAM B. WOLF, SR. *
WILLIAM B. WOLF, JR. *
CHARLES F. GOLDSMITH *
CHARLES J. PILZER *
WILLIAM E. SHANNON *
as General Partners of *
MIDCITY INVESTMENT COMPANY *

SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

Tax Docket No. 3927-87

Petitioners

v.

DISTRICT OF COLUMBIA

Respondent

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This matter came before the Court upon the petition filed by the above-named petitioners for a partial refund of real property taxes for tax year 1987 and the answer of the District of Columbia. Upon consideration of same and the evidence adduced in open court, and having resolved all questions of credibility, the Court makes the following:

Findings of Fact

1. The matter in controversy is for real property taxes for Tax Year 1987 for Lots 2 and 3 in Square 164, improved by an office building known as 1001 Connecticut Avenue, N.W., Washington, D.C.

2. The subject property is owned by MidCity Investment Company, a limited partnership. The general partners of MidCity Investment Company are the petitioners.

3. The subject property is a twelve story office building located at the corner of Connecticut Avenue and K Street, N.W. in the District of Columbia. The property has an address of 1001 Connecticut Avenue, N.W., although its entrance is on K Street. The building was built in 1953. The building is constructed of brick, stone, concrete and steel. It has a lobby and stores on the ground floor and in the basement, where there is also storage space. A part of the building was taken in 1971 for subway construction. A perpetual easement was given for which the owner was paid a lump sum. The building has no garage. It has four elevators. The mechanical systems are about the age of the building. The building has not been renovated in recent years. In some instances, partitions have been installed for tenants. The assessment record card shows \$35,000 for remodeling in 1968. The owners have not increased the power for the usage of tenants having extensive computer operations. The building's condition is described as average on the District's assessment record card.

4. For Tax Year 1987 (valuation date 1/1/86), the preliminary assessment proposed by the Department of Finance and Revenue (DFR) was as follows:

Land	\$12,756,120
Improvements	<u>\$10,142,880</u>
Total Proposed Assessment	\$22,899,000

5. The Board of Equalization and Review reduced the assessment to \$18,912,250. The explanation for the decision

was that the Board agreed with the original assessment prepared by James E. Conway, Jr., the District's assessor. He used an economic stabilized net income of \$2,254,340 and a capitalization rate of .1192 in determining value by the income approach. The Board deemed this most reliable.

Thus, the assessment reached was as follows:

Land	\$12,756,120
Improvements	\$ <u>6,156,130</u>
Total Assessment	\$18,912,250

The required taxes were paid, and a timely appeal was made to this Court from the decision of the Board of Equalization and Review.

6. James E. Conway, Jr. was the District's assessor for the subject property for tax year 1987. In calculating a fair market value of \$18,912,250 for the property, the assessor did not use the income and operating expense figures which were submitted to the government by petitioner. He also admitted that he did not use the actual vacancy and credit losses as reported by the taxpayer. Mr. Conway did not explain the basis for utilizing the figures that he used. He acknowledged that some of the figures might be in error. Thus, Mr. Conway's original assessment appears to be flawed. The initial assessment made by Mr. Conway was not the proposed assessment made by the District for tax year 1987. In fact, as stated in the foregoing findings, the District ultimately proposed an assessment of \$22,889,000.

7. Robert L. Klugel, is the Chief of Standards and Review for the Division of Real Property Taxes for the Department of Finance and Revenue for the District. He has worked in the division for 24 years and served as its chief for 8 years. The Standards and Review section is responsible for establishing methodology to be used by assessors and for establishing equalization for tax purposes. Mr. Klugel, who is familiar with the subject property, participated in the review of the assessment for the subject property for tax year 1987. Mr. Klugel reviewed a computerized work sheet of Mr. Conway in which he had recommended a valuation of \$23,122,000 for the property. Mr. Klugel recommended a reduction to \$22,899,000 for equalization purposes. Print-outs are utilized by the department, which list the values per square foot for other properties in the area. Based on that data, Mr. Klugel concluded that \$164.78 per square foot was within the range for the properties in that area. Mr. Conway was using a figure of 138,969 square feet as the net rentable area for the property. Mr. Klugel was using 142,164 square feet for total net rentable area. The discrepancies in the net rentable area for the property are discussed hereinafter. The proposed assessment for the year made by the respondent was the figure recommended by Mr. Klugel of \$22,899,000.

8. There is an admitted discrepancy in the various figures used and reported. The Annual Leasing Reports (Rent

Roll) for 1985 and 1986 submitted by the owner's agent show the total rentable area (leased and vacant) to be 140,768 square feet. (See Respondent's exhibits K and J). Yet, figures in column 4 do not support the total reflected. For 1985, the total area of square feet reflected in column 4 is 141,564. The total for 1986 as set forth in column 4 of the Annual Leasing Report is 134,050. The Income and Expense forms for 1984 and 1985 submitted by the owner show 124,538 square feet of net leasable office area and 16,230 square feet of net leasable commercial space for a total of 140,768. In calculating a value for the building and in making rent roll adjustments to determine value, respondent used the figure submitted by the taxpayer of 16,230 square feet for rental space. However, he used 125,934 square feet of office space instead of the figure provided by the taxpayers. Thus, he reached the total of 142,164. There is a discrepancy of 660 square feet between the number used by the District in its calculations and the total square feet computed by adding column 4 on respondent's exhibit J, which purportedly reflects all rentable area leased and vacant. The reason for these discrepancies was never adequately explained. However, the figure for net rentable used by Mr. Conway was clearly too low. The figure used by Mr. Klugel is closer to the number of square feet identified in detail as either leased or vacant in the building.

9. At trial Mr. Klugel concluded that the fair market

value for the property on the valuation date for tax year 1987 was \$22,430,000. To reach this conclusion, Mr. Klugel examined the property's income and expense history for 1983, 1984, 1985. He accepted and used petitioner's actual reported operating expenses (\$852,111) for capitalization purposes. However, he made an upward adjustment of \$605,440 to the reported collected income of \$2,727,477, as reported by petitioner's accountant, to arrive at a stabilized gross of \$3,332,917 for the property. The adjustments to gross income made by Mr. Klugel are reflected on respondent's exhibit L. Mr. Klugel made the adjustments to rents because he noted an increase in rents from 1985 to 1986 for space not previously occupied. He also considered that some leases in petitioner's property had pass-through provisions for increases in expenses and taxes and for CPI adjustments. He found some leases to be below market. Mr. Klugel arrived at an adjusted net income for capitalization purposes of \$2,480,806. After making the adjustments, he concluded that the average building rent was \$23.44 gross per square foot and \$17.45 net per square foot of rentable area. These figures he found to be supported somewhat by comparison with rents for other properties.

10. While some of Mr. Klugel's adjustments were supported by the evidence, others were not. On the twelfth floor, Wolf and Wolf (the firm of some of MidCity's general partners) paid only \$3.33 per square foot for 1984 and \$3.96

per square foot of rent in 1985 for 2275 square feet of space. Petitioner's witness conceded that the firm was receiving a rent concession of approximately \$45,000. An adjustment should be made to reflect this concession. The Court is not persuaded that the concession is justified because the firm keeps a watchful eye on the investment. There is a management agent for the property. The services, if any, rendered by the law firm, the value of such services and any other remuneration received for them and other factors which would justify this substantial concession have not been established by a preponderance of the credible evidence.

An adjustment to income is proposed for 850 feet on the 7th floor. The tenant, Parker, Chapin, Flatten appear to be on a month to month lease. No plausible reason has been given for the rental remaining at \$16.80, a rate below market. An adjustment to economic rent of \$20.00 per square foot would amount to \$2720. Two of the offices on the 5th floor for which Mr. Klugel proposes an adjustment consists of 525 square feet of space based for \$9.98 on a month to month basis. An adjustment to market rent of \$20.00 proposed by Mr. Klugel appears appropriate. This would result in an upward adjustment of \$10.02 for the 525 square feet or an increase of \$5260.50. An increase to the market rent potential proposed by the District's witness would result in an increase of \$1000 for the 200 square feet. The

adjustment for the 2nd floor month to month tenant with 994 square feet at \$8.79 in 1984 and \$9.87 in 1985 is persuasive. Taking the average rent for the two years and subtracting it from market rent, an adjustment of \$10.69 per square foot for a total of \$10,625.86 results. Finally, respondent's witness proposed an adjustment for 10,070 square feet of "prime retail" space on the first floor. However, at the hearing, Mr. Klugel conceded that there are only 8220 square feet of retail space on the first floor. Apparently, some of the space that was formerly leased by Lewis and Thomas Salz, which was included in the original estimate of the 1st floor space, was in the basement. The prior tenant had a lease negotiated in 1955 which would not expire until 1991. Petitioners purchased the balance of the leasehold interest from the prior tenant in 1986 for just over \$300,000. This transaction was not consummated until after the valuation date for tax year 1987. As of the valuation date, it appeared that the lease would depress the income for the next five years. This was a circumstance to be considered by any prospective buyer at that time. Under the circumstances, no adjustment should be made for tax year 1987 for income potential for this space. It would have been too speculative in view of the subsisting lease. Therefore, the total amount of the adjustments to income recommended by Mr. Klugel to reflect the potential income stream of the property which has been shown to be justified

totals \$64606 (rounded) instead of \$604,440. The remaining adjustments suggested by Mr. Klugel are not convincing. It appears that the spaces covered are subject to leases, made at arms-length which have terms which would preclude adjustments for some time. Therefore, the remaining adjustments are not accepted.

11. Mr. Klugel applied a capitalization rate of .1106 to the net operating income to reach a value by the income capitalization approach. This method is used to convert a projected income stream into an indicated value for the property.

$$\text{Value} = \frac{\text{Net Income}}{\text{Capitalization Rate}} \quad \text{or} \quad \frac{2,480,806}{.1106} = \$22,430,433$$

Mr. Klugel rounded his figures and reached the conclusion of an indicated value for the property of \$22,430,000. The justification for the capitalization rate of .1106 selected by respondent is explained on respondent's exhibit M. The rate selected took into consideration that the property was able to obtain a loan at an interest rate of 11% with a loan to value rate of 65% for 25 years amortized. He also took into consideration the property's equity position. The assessor considered an investment of 5 years and the increase in the property value overtime. Petitioner did not refute the capitalization rate used by respondent nor the methodology used for achieving it. This aspect of Mr. Klugel's projections seem reasonable.

12. Mr. Klugel checked his conclusions by analyzing market data. Having concluded that the subject property was valued at \$22,430,000 and using a figure of 142,164 square feet of net rentable area, he reached the conclusion that the subject property is worth \$157.78 per square foot of net rentable area. Mr. Klugel checked his conclusion of value which he arrived at by the income capitalization approach by a review of 17 office building sales in the vicinity of the subject property (respondent's trial Exh. Q). Mr. Klugel noted two sales of office buildings (located at 1741 Rhode Island Avenue, N.W. and 1250 Connecticut Avenue) as susceptible of comparison to the subject. The sale of these two office buildings produced sales prices per sq. ft. of net rentable of \$180.92/ sq. ft. and \$162.34/ sq. ft.

13. Mr. Klugel's methodology appears sound. However, the number of square feet used is not consistent with the evidence. The total indicated value is not the value to be tested with the rejection of certain adjustments proposed by Mr. Klugel. Thus, the figures should be tested using the allowable adjustments and the maximum floor area indicated by the evidence. Mr. Klugel's adjustment must be reduced by \$539,934. This reduces his net income figure to \$1,940,972. Using Mr. Klugel's methodology and only those adjustments found to be supported as stated in the findings, the following indicated value would result:

$$\text{Value} = \frac{1,940,972}{.1106} = \$17,547,197$$

Using this figure and the 141,564 square feet of rental area shown on the rent rolls, the value would be \$123.95 per square foot of net rentable area. While not equivalent to the properties compared by Mr. Klugel, the figure is comparable to some of the sales prices per square foot of net rentable area for some of the older buildings listed on page 2 of respondent's exhibit Q. Considering the lack of renovation on the subject property, that the price is somewhat less than other sales in the area does not suggest that the indicated value is understated. The Rhode Island Avenue property referred to by Mr. Klugel was remodeled in 1976. The Connecticut Avenue property was built about eleven years after the subject. Moreover, Mr. Klugel testified that the sales prices for the buildings are only indicators of value.

14. In contrast, using the two opinions of value offered by petitioners, a substantially lower value per square foot of net rentable area results. Petitioners' witness would value the property at \$10,356,360 by one method and \$13,000,000 from an "economic view." Using these figures and the same number of square feet of rentable area used by respondent results in a value of \$72.85 or \$91.44, depending upon which value is used¹. Petitioners' values do not approach the sales prices for any property which sold

¹If the number of square feet of net rentable area is 141,564, then the values would be \$73.16 or \$91.83.

in the area. Although each property has unique characteristics, the sales are considered to be some indication of value. The indicators would not be supportive of either value suggested by petitioner.

15. There is in evidence a listing of land sales in the area. In 1984, the land at 1124-30 Connecticut Avenue, N.W., which is close to petitioners' building, sold for \$1000 per square foot of land area. Land located at 705 18th Street, N.W. sold for \$1194.40 per square foot of land area, and the land of 728, 730 - 17th Street, sold for \$998.03 per square foot of land area. Both properties are in close proximity to petitioners'. If the property were valued at \$10,356,360 as suggested by petitioners and only the land component (13,260 square feet) were considered, the land would be valued at only \$781.02 per square foot. The value assigned to the land is proposed by the District is \$12,756,120 or \$962 per square foot. This figure is more comparable with other land values cited.

16. Petitioners' major witness, William B. Wolf, Jr. is an attorney who has had some experience in real estate valuation. He is one of the general partners of the partnership which owns the subject property. He has been a principal in 7 or 8 organizations which have purchased buildings in downtown Washington. He has acted as counsel in many property transactions and in financing. He served on the Board of the Security National Bank for a number of

years. He chaired certain committees which were concerned with property values. He does not claim to be an appraiser of real property, nor does he contend he ever worked as an assessor. Mr. Wolf has extensive knowledge about the physical characteristics and leasing history of the subject property, which the partnership acquired in 1955. He is involved in decision making for the property (e.g. tenant concessions and major improvements).

17. It is one of the opinions of petitioner's witness that the value of the property was \$10,356,000 as of January 1, 1986, the valuation date for tax year 1987. This figure represents the assessed value for 1984. The reasons for the opinion of this value is the witness' belief that the property did not increase in value between the 1984 valuation date and the valuation date for tax year 1987. Of course, there were higher assessments for intervening years. No persuasive reasons were given for the selection of the 1984 tax assessment as the appropriate value for tax year 1987. No reasonable explanation was given for the reduction in value of the property. The selection of the figure appears to be arbitrary.

18. The petitioners' witness believed that the increased office rental activity on Pennsylvania Avenue, on M Street and in Virginia adversely affected the rental market at the location of the subject property. Yet, the witness admitted that the economic performance for the

building improved since 1984. The witness' opinion was that the value was flat. Although he noted that rents have not changed much when tenant concessions are considered, petitioner's income and expense forms for 1984 and 1985 show a substantial reduction in 1985 in the category, Vacancy and Credit Loss, under which petitioner also includes tenant concessions. In 1984, the amount listed is \$181,847. In 1985, the amount shown is \$62,777. The total expenses for 1985, exclusive of taxes is shown to be \$881,072, while the total expenses for 1984 are reflected at \$928,677. The actual gross income for 1985 at \$2,717,869 is an improvement over 1984 at \$2,347,308.

19. Petitioners' witness' conclusions do not appear to be supported by the objective data. In addition to the increase in actual gross income over the two years provided and the decrease in expenses, the documentary evidence supports the testimony of Mr. Klugel that many of the leases on the space in the property contain provisions for pass-through of operating expenses and taxes and that rents increased for space not previously rented. The reduction in the category in which vacancy losses are reported also weigh against Mr. Wolf's conclusions that the property was adversely affected by the "bursting west" phenomenon or the rental activity in other locations. Petitioners failed to provide other evidence which would support the conclusions that the rental income had not changed and that the value

remained constant from 1984. Although the witness indicated that the condition of the building and the need for reroofing reduced its value, the amount of the reduction in value was not quantified. Neither the cost of any anticipated renovations nor an estimate of the amount of reduction in value based on such projections was offered in evidence. The primary basis for the witness' conclusion of a value of \$10,356,360 was that the building had not appreciated since the 1984 Tax year (valuation date of 1/1/83). The selection of the value for tax year 1984 is arbitrary and unconvincing.

20. Petitioners' witness also suggested that from an economic view the building is worth \$12,896,000 or \$13,000,000 rounded. He arrived at this figure by adopting from respondent's proposal a 14% return on cash investment. Beyond this, the figure was not explained satisfactorily.

21. Petitioners' major witness did not consider the comparable sales approach, as he claims there are no comparable properties. He made no effort to review similar properties and to adjust for dissimilarities as an appraiser would. The witness felt that absent information about the leasing and financing for other properties, a comparable sales approach would not be helpful. He claims to have used the income approach while "cranking in" market conditions (e.g. relocating of firms from the area). How these factors impacted on the values suggested was not shown. The witness

acknowledged that he did not consider a projected income stream for the property in his "income approach" to value. Petitioner's witness was unable to assign the total value between the land and the building. He noted only that without the building, the land would be valuable, while he concluded that the building somehow suppresses the value of the property because it is encumbered by leases and a mortgage. The witness' testimony was not persuasive as to either of the values suggested.

22. Petitioners' witness did not utilize the three normally accepted approaches to value (i.e. cost, sale comparison, income capitalization). The selection of tax year 1984 as the basis for value in 1987 appears to have been arbitrary and unsupported by specific data. The generalizations made about the market condition by the witness are not persuasive support for the figures submitted by the witness as fair market value. Additionally, petitioners were able to obtain a loan of approximately \$7 million in 1984. The minimum valuation required by the bank which provided the loan would have been \$11,700,000. This minimum valuation is above the figure petitioners urge as the fair market value of the property of \$10,356,360. The actual appraised value used by the bank is not in evidence.

23. Petitioners' witness stated that he makes no allocation between the land and the building. Nevertheless, an allocation must be made. No challenge was made to the

manner in which the District allocated total value between land and building. Mr. Conway proposed a land value of \$12,756,120. The land value was retained by the District when it proposed the 1987 assessment. The land value at this amount would be \$962.00 per square foot. As previously stated, this is consistent with land sales for similar properties in the area is shown by the evidence. Under the circumstances, and absent any evidence to the contrary, the \$12,756,120 for which the land was valued should be maintained. The improvement component would represent the difference between the total and the land component. Thus, the assessed value supported by the credible witness would be as follows:

Land	12,756,120
Improvements	<u>4,791,077</u>
Total Assessment	17,547,197

Conclusion of Law

Petitioners have the burden of proving that the assessment is incorrect or illegal. Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987).

Petitioners have met this burden. First, they have shown that Mr. Conway failed to use the actual income and operating expense figures submitted by the taxpayer for the actual vacancy and credit loss as reported. Mr. Conway could not explain the basis for the results reached. Thereafter, his figures were adjusted upward by the standards and review section of the District. The amount of

the proposed assessment at that time was \$22,899,000. At trial, the District abandoned this figure for a lower number. It also appears that there was some confusion by the District regarding the number of square feet of total net rentable area for the building. This resulted in flaws in the calculations which tested the values reached and the adjustments made by the District.

Petitioners are not required to establish the correct value of their property. Brisker v. District Columbia, 510 A.2d, 1037, 1039 (D.C. 1986). Although they are not required to do so, they attempted to propose a value for the property. Considering the qualifications and credibility of petitioners' witness, the reasons given in support of his conclusions, and the evidence in the case, it appears that petitioners' conclusions of values of \$10,356,000 or \$13,000,000 are not valid. The figures are against the weight of the evidence. The suggestion of two different figures as the fair market value undermines his opinions of fair market value also.

The generally recognized approaches to value are the comparable sales approach, the replacement cost approach, and the income approach. Safeway Stores, Inc. v. District of Columbia, 525 A.2d at 209. Although petitioners' witness claims that he employed the income approach to value, he did not take into consideration the potential income stream for the property. Petitioners' witness utilized the formula for

the income capitalization approach. However, he did not use a stabilized annual net income figure for a figure to represent the income earning potential for the property. See Safeway Stores, Inc. v. District of Columbia, 525 A.2d at 209; District of Columbia v. Washington Sheraton, Inc., 499 A.2d 109, 113-114 (D.C. 1985). Petitioners' witness also failed to consider any other approaches to value. He did not test his figures by considering other approaches to value. In assessing real property and determining estimated market value, the District must consider the factors having a bearing on the subject, including sales information of similar properties, mortgage and other financial considerations, reproduction cost less accrued depreciation, condition, income earning potential and other factors having a bearing on the subject. D.C. Code §47-820(a)(1981); Safeway Stores, Inc. v. District of Columbia, 525 A.2d at 209. Petitioners' witness failed to consider adequately such matters. Although he attempted to take into account the age and condition of the building, the extent to which such factors affected the estimate of fair market value could not be determined from his testimony. The foregoing considerations require rejection of the estimates of market value proposed by petitioners.

In estimating fair market value, the District is required to consider the factors which may be equated with the generally recognized approaches to value (i.e.

comparable sales approach, replacement cost approach, and the income approach). Id. The replacement cost approach was not discussed by the witnesses for respondent. However, it appears that such an approach would not be appropriate under the facts of this case. The methodology employed by the District's primary witness seems reasonable and appropriate in all respects. It took into account both the income approach and the comparable sales approach. The witness relied most on the income approach to value. The only area in which the witness' estimate of fair market value did not seem to be supported by the evidence was in the adjustments made to income. The adjustments by the witness appeared to be excessive, considering the leases in the building and the age and condition of the building. The Court finds it appropriate to accept the methodology employed by Mr. Klugel, but to reject some of the adjustments he proposed. After weighing his credibility and qualifications and the reasons given in support of his opinion, the Court finds his methodology is sound and consistent with the methods used to determine the value of real property in the District of Columbia. The witness has extensive experience actually determining fair market value. He was able to support his conclusions with the evidence. The Court is persuaded that some of his proposed adjustments were appropriate to reflect potential income of the property as required by current authorities. Safeway Stores, Inc. v.

District of Columbia, 525 A.2d at 213; District of Columbia v. Sheraton Corp. 499 A.2d at 113-114 (D.C. 1985); Rock Creek Plaza-Woodner Ltd. v. District of Columbia, 466 A.2d 857 858 (D.C. 1983). Using the witness' methodology and eliminating inappropriate adjustments, the fair market value of the property can be determined.

When a taxpayer appeals to the Superior Court, the Court may affirm, cancel, reduce or increase the assessment. D.C. Code §47-3303 (1981); See Rock Creek Plaza-Woodner Ltd. v. District of Columbia, 466 A.2d 857, 859 n.1 (D.C. 1983). A decrease in the assessment is warranted by the evidence. Consistent with the methodology employed by Mr. Klugel and the adjustments found justified by the Court, the Court concludes that the fair market value of the property as of January 1, 1986, the valuation date for tax year 1987 the value was \$17,547,197 with 12,756,120 attributable to the land and the balance attributable to the improvements.

It is therefore by the Court this 22nd day of June, 1990,

ORDERED, that the assessed value for the property is determined to be as follows:

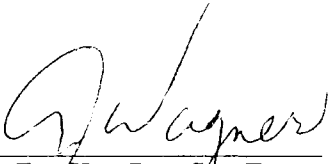
Land	\$ 12,756,120
Improvements	<u>4,791,010²</u>
Total Assessments	\$ 17,547,130

It is further

ORDERED, that the parties shall submit to the Court on

²This figure has been rounded.

or before the 6th day of July, 1990, a
proposed order for an adjustment in the assessment records
and a refund for the overpayment of taxes due to the
petitioners consistent with this Order.

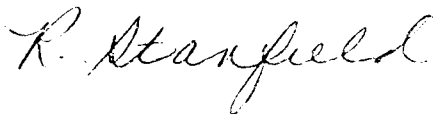

J U D G E
Signed In Chambers

Copies mailed this 25th day of June, 1990 to each of the
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6/25/90