

FILED

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

AUG 23 1 55 PM '93

NEW YORK LIFE INSURANCE CO.,  
et al.,

Petitioners,

v.

DISTRICT OF COLUMBIA,

Respondent.

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SUPERIOR COURT OF THE  
DISTRICT OF COLUMBIA  
TAX DIVISION

Tax No. 4258-89

FINDINGS OF FACT, CONCLUSIONS  
OF LAW, AND JUDGMENT

This case came on for trial upon Petitioner's appeal from an assessment for real property taxes for tax year 1989. The parties filed Stipulations pursuant to Super. Ct. Tax R. 11(b). Upon consideration of the stipulations, the evidence adduced at trial, and having resolved all questions of credibility, the Court makes the following:

FINDINGS OF FACT

1. The subject property is owned by New York Life Insurance Company ("NYLIC"), a corporation organized and existing under the laws of New York and George Washington University, a private institution organized and existing under the laws of the District of Columbia. Petitioner NYLIC is obligated to pay all real estate taxes assessed against the subject property.

2. The subject property is located at 1333 H Street, N.W, Square 250, Lot 46, in the District of Columbia. It 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 property, 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 five floors remained a gutted shell as of the valuation date, January 1, 1988. These floors were unoccupied. The property is located in an area of porno establishments. The building has three levels of underground parking for 245 cars. The main building has 213,409 square feet of net rental 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.

3. The assessment for tax year 1989 as of January 1, 1988 was \$41,920,500. Petitioners timely appealed to the Board of Equalization and Review (BER). The BER sustained the assessment at \$41,920,500.

4. Petitioners paid the tax year 1989 taxes in the amount of \$50,986.15 in full, prior to filing the petition in this case.

5. Petitioners filed suit seeking a reduction in the assessment and refund of excess taxes paid. In its Petition, petitioners asserted that the fair market value of the property was \$37,200,000. At trial, Petitioners amended their claim to \$34,000,000, the value set by their expert appraiser.

6. Mr. Larry Hovermale was the tax assessor for the subject

property for tax year 1989. Mr. Hovermale 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 property. He testified that he primarily relied on the income approach. The comparable sales approach was used as a check.

7. Employing the income approach to value, Mr. Hovermale 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, \$4,204,626, was substantially in excess of the actual income experienced by the owner. The 1987 net income was shown at \$3,496,976. Mr. Hovermale testified that he selected a market rental rate of \$23.00 per square foot from an analysis of the income reported by other buildings. However, he could not identify which properties he used. He stated that he did not make any adjustments for actual income, actual expenses, or vacancies. The projections of the assessor regarding income were not supported by the information applicable to the real property in question. Thus, the assessor's stabilized projected income appears to be overstated and not reasonably related to the real property in this case.

8. The assessor then applied an overall capitalization rate of .1003. The witness was instructed to use this capitalization rate by the Chief of Standards and Review. The actual basis or source of this capitalization rate was not otherwise explained by

Mr. Hovermale.

9. In the comparable sales approach, the assessor reviewed sales information for certain properties which he deemed to be comparable. The 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) make doubtful the comparability of those properties. Mr. Hovermale made no adjustments to the comparable sales as compared with the subject property.

10. The foregoing facts show substantial flaws in what the assessor said he did which would have resulted in an erroneous assessment.

11. Both sides offered expert testimony. Mr. Anthony Reynolds appraised the subject property for Petitioners. Mr. Reynolds has been a member of the Appraisal Institute for several years. He served as President of the national organization in 1983. He also was president of the local chapter. Mr. Reynolds is a member of the American Society of Real Estate Counselors and numerous other organizations associated with the field. He is also designated as an instructor by the Appraisal Institute. He has qualified as an expert in the field in various courts. At trial, this court qualified him as an expert witness.

12. Respondent called Ms. Shinn C. Back as its appraiser who was offered as an expert witness. While Ms. Back has been designated a member of the Appraisal Institute, she had never

testified as an expert in a real estate tax case. Prior positions include work as an assessor for the District of Columbia and as an appraiser for Citibank in New York City. Ms. Back was nonetheless qualified as an expert in the field of real property appraisal.

13. Both appraisers considered and rejected for use in the appraisal for the subject real property, the cost approach. This method 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. Such method is not appropriate for the subject property.

14. Each appraiser arrived at the land value by considering comparable sales and adjusting for dissimilarities with the subject. Mr. Reynolds accepted the assessor's valuation of \$22,751,034; Ms. Back, however, valued the land at \$22,200,000.

15. In estimating the value of the whole property, both appraisers applied both the income approach and comparable sales approach. To arrive at an indication of value by the income approach, Mr. Reynolds examined the income and expense history for five years between 1983 and 1987. He reviewed the rent rolls and leasing history for the building. Mr. Reynolds testified that he used the actual rents received by Petitioners for the space actually leased. He applied an economic rent of \$21.00 per square foot to the vacant space in the Landmark Building and \$23.00 per square foot to the vacant space in the East Building. Mr. Reynolds added parking income of \$259,145 and \$249,248 in escalations and reimbursements, excluding real estate taxes. This resulted in a

total potential gross income of \$5,491,572. From this figure, he subtracted a stabilized 5% vacancy factor to arrive at an effective gross income of \$5,216,994.

16. In making her appraisal based on the income approach, Ms. Back testified that she examined comparable leases to arrive at her estimate of economic rent at \$24.00 per square foot for both buildings. Ms. Back applied this figure to the vacant office space. She also included escalations and reimbursements totaling \$418,500 which included real estate tax pass-throughs. Her total potential gross income was \$6,113,018. She deducted a vacancy factor of 8% to arrive at her effective gross income of \$5,515,977.

17. Mr. Reynolds stabilized expenses at \$5.80 per square foot, based on typical operating expenses in comparable buildings. The range reported was \$4.11 to \$6.87 per square foot. He explained that the increase from actual 1987 expenses of \$4.59 to \$5.80 was because he stabilized the income at 95% occupancy whereas the prior year it was only 92% occupied. Mr. Reynolds' net operating income was \$3,787,427.

18. Ms. Back determined the expenses to be deducted at \$5.26 per square foot excluding real estate taxes. Her initial net operating income was \$4,225,030, compared to Mr. Reynolds' \$3,787,427.

19. To determine the capitalization rate for the subject, Mr. Reynolds examined rates derived from the market. All of the sources examined pointed to a capitalization rate of 8.25% to 9.4% for January 1, 1988. (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. He examined the American Council of Life Insurance tables and the Washington, D.C. office building market. He testified that the subject is not a prime office building and that due to its inefficient split nature, Mr. Reynolds chose a real estate rate of 8.5%. After deriving the overall rate, the appraiser adjusted for the tax by a factor of 2.03% to arrive at an overall rate of 10.53%.

20. Mr. Reynolds applied his capitalization rate of .1053 to a stabilized net operating income of \$3,787,427 to reach the sum of \$35,967,968.

21. Ms. Back testified that her capitalization rate was also derived from market data. She examined various rates in the market place. Using the mortgage-equity formula, she assumed a 40% appreciation in value over a hypothetical 10 year holding period and a sale at the end of the holding period. This is highly speculative. She also derived capitalization rates from comparable sales. Her conclusions indicated a range for the capitalization rate of between 7.1% and 7.59% for the real estate. She determined a rate of 7.5% plus taxes to yield a total rate of 9.5%, compared to Mr. Reynolds' 10.53%. Ms. Back applied her capitalization rate of 9.5% to her stabilized net operating income of \$4,225,030 to yield \$44,474,000.

22. Both witnesses made further deductions for leasing the property. Mr. Reynolds subtracted \$22.00 per square foot applied

to the 25,438 square feet of vacant space in the property for finishing costs. He also subtracted leasing costs and lost rent. Mr. Reynolds made an adjustment for incentive on occupancy costs at 15%. Finally, he deducted \$503,774 to correct problems in the basement. These problems included flooding and structural supports underpinning the sidewalks. After these deductions, his final value is \$34,000,000.

23. Ms. Back testified that she too made certain deductions. She allowed for tenant improvements at \$26 per square foot and leasing commissions on 18,453 square feet of the vacant space. After the deductions, she arrived at a value of \$43,889,500, rounded to \$43,900,000.

24. Both appraisers also made valuations based upon comparable sales. Mr. Reynolds testified that he examined the market and determined that five sales could be adjusted to compare with the subject. He stated that he had appraised some of the properties previously. All but one were adjusted down because, he testified, in his judgment, he considered them superior to the subject. He used \$155.00 per rentable square foot to arrive at his value of \$38,203,935 before deductions for the extra parking income, the inefficiencies of the subject and lease-up costs. His final conclusion of value by the comparable sales approach is \$34,000,000.

25. Ms. Back also made an appraisal based on comparable sales. While she examined several of the same sales that Mr. Reynolds used, she concluded that the properties were, overall,



inferior to the subject. Thus, she adjusted most of her comparables up to an average of \$190.00 per square foot of net rentable area compared to Mr. Reynolds' \$155.00 per square foot.

26. A cash flow analysis of the property using Ms. Back's own net operating income indicated that her value of \$43,900,000, was not the fair market value of the property. Applying Ms. Back's figures to the subject property, results in a negative cash flow for the property after debt service. It is not likely that a prospective purchaser would buy the property at a price that would after market rents and debt service yields a negative cash flow. This is very strong evidence that Ms. Back's valuation does not reflect market value.

#### CONCLUSIONS OF LAW

This Court has jurisdiction over this appeal pursuant to D.C. Code § 47-825 and 47-3303 (1990 Repl.). The Superior Court's review of a tax assessment is de novo. In appealing from assessments of real property for tax purposes, the taxpayer 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.

Petitioners have met the burden of proving that the assessment made by the District was erroneous and flawed in a number of respects. To the extent that the income approach to value was employed, the projection 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., 449 A.2d 109, 115 (D.C. 1985); Rock Creek Plaza-Woodner, Ltd. v. District of Columbia, 446 A.2d 857, 858 (1983). The assessor for this property admitted that he gave little or no consideration to the actual income, expenses, current leases or lease-up costs of the property. These factors affect the ability of the property to achieve market rents today and in the future. Without consideration of these factors, utilizing the average net operating income of buildings in a particular category is an arbitrary and unreasonable method for determining a property's net operating income.

In District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 115 (D.C. 1985), the Court stated that "[w]hen an income-producing property has been in operation for a period of time, its past earnings assist the assessor in projecting future earning ability." The Court also stated that the market value of an income-producing property includes the present value of the property's future income. Washington Sheraton Corp., supra, 499 A.2d at 115. Therefore, to arrive at a reliable estimate for the net operating income of the property, the District must consider not only market conditions, but the actual and present experience of the property as well.

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, supra, p. 858. The capitalization rate: "a number representing the percentage rate that taxpayers must recover annually to pay the mortgage, to obtain a fair return on taxpayers' equity in the property, and to pay real estate taxes." Id. at p. 858. The capitalization rate used by the assessor in this case was provided him by other members in the Department of Finance and Revenue. Its origin could not be determined otherwise. There is no showing as to what it was derived from. When the figure used by the assessor was applied, it 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. The improper projection of the stabilized income and the use of a capitalization rate of unknown or doubtful derivation make the calculation unreliable. All of the foregoing factors demonstrate that petitioners have met their burden of showing that the assessment for the tax year in question was erroneous and flawed.

In this case, the petitioners have shown not only that the assessment made by the District were flawed and erroneous, but they have produced competent evidence of the actual value of the property by a well-qualified real estate appraiser. The testimony of petitioner's expert on balance, the Court concludes is more creditable than the testimony of the assessors and the respondent's

expert, therefore, the Court rejects the conclusions and estimate of Ms. Back. Both appraisers valued the subject property for the tax year using the income approach 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, Mr. Reynolds was appropriately concerned with the actual estimated value. Real property taxes in the District of Columbia 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). Mr. Reynolds determined the full value of this property consistent with the statutory definition.

As required, both witnesses considered and rejected the one other approach to value. While the building was of recent vintage, it had sufficient income history to allow for meaningful projections of value by an 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 Mr. Reynolds are reasonable. Mr. Reynolds 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 and made adjustments where appropriate and

arrived at the actual market value. The methodology and rationale of the Petitioner's expert is the most sound and reasonable of all of the person's who purported to determine the value of the property in question.

Mr. Reynolds accepted the District's estimate of the land value which was supported by all of the evidence. For tax year 1989, the total value as of the valuation date of January 1, 1988 was \$34,000,000 with \$11,248,966 allocated to the improvement and \$22,751,034 allocated to the land.

Having accepted the finding 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 16th day of AUGUST, 1993,

ORDERED, ADJUDGED AND DECREED as follows:

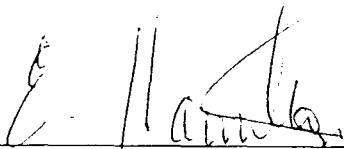
1. That the estimated market value of this subject property was \$34,000,000 for tax year 1989, of which \$22,751,034 is attributed to the land component and \$11,248,966 to the improvement.

2. 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.

3. That the respondent shall refund to petitioners any excess taxes collected for tax year 1989 resulting from assessed values used as the basis for such taxes which exceed those determined by this order.

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

SO ORDERED.



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Eugene N. Hamilton  
Judge

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