SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

(Tax Division)

NATIONAL PRESS BUILDING

Petitioner

v. Tax Docket Nos. 5750-93

DISTRICT OF COLUMBIA

Respondent

FINDINGS OF FACT
CONCLUSIONS OF LAW, AND JUDGMENT

This case was tried upon the petition for a reduction of the real property tax assessment and refund of excess taxes paid for tax year 1993, and respondent's answer thereto. The parties filed stipulations pursuant to Rule 11(b) of the Tax Division Rules of this court. Considering the record herein and the evidence adduced at trial, and having resolved all questions of credibility, the court makes the following:

Findings of Fact

1. Petitioner National Press Building Corporation owns the subject property at 529 14th Street, N.W., Square 254, Lot 53, and is reponsible for, and paid, all assessed real estate taxes. Petitioner timely appealed the tax year 1993 assessment to the Board of Real Property Assessments and Appeals ("Board"), as required by statute, seeking a reduction in the assessment and a refund of taxes paid, asserting that the fair market value of the subject property was less than the assessment figure.

2. The subject property is located on the eastern edge of downtown Washington known as both the central business district or

Pennsylvania Avenue Development Corporation district, south of the East End. This newly desirable area has experienced a considerable amount of construction and renovation activity. The subject's location is excellent, with easy access to shopping, the convention center, other commercial enterprises, and, most important, Metro Center, the only transfer point for every Metro line. The highest and best use of the subject land is development as an office structure to the maximum FAR allowed by the site's C-5 zoning.

3. Larry Hovermale, the District's assessor, testified that he performed an independent assessment of the subject property. He first considered the three approaches to value required by statute—income, comparable sales, and cost—then selected the income approach as the primary approach, with the comparable sales approach used as support. Mr. Hovermale primarily relied upon the 1990 Income/Expense statement and rent roll submitted by the owner, although he reviewed similar statements from the prior two years.

4. Mr. Hovermale determined the land value by reducing the tax year 1992 value by 18%. This percentage reduction was determined by the Department from an analysis of both land sales occurring in the central business district and the extraction of land values from improved sales data, and was applied to accurately reflect the reductions experienced in the District of Columbia's real estate market. This was done independently of his valuation of the fee simple value of the subject property based upon the income approach.

5. In developing his assessment for tax year 1993, Mr. Hovermale used an office net effective rent of $32.68/SF in projecting economic income, used an expense rate of $8/SF to account for the higher-than-typical expense reported by the subject, and a vacancy and credit loss rate of 4%. He reviewed the Income/Expense statements statutorily required from all property owners (they are certified to be complete and accurate), and the net operating income he determined was less than that reported by the owner. Mr. Hovermale testified that he divided this figure by a capitalization rate of 9.5%, within the range of 9.25-11.00 percent determined by the Department as appropriate for this tax year. He testified that his rate was proper for the subject, given its excellent location, good condition resulting from a major renovation in 1985, and its treatment as a 1980s building. Mr. Hovermale testified that he accounted for tenant concessions by reducing the office income by 14%—an amount equal to $1,789,000—and that leasing commissions were accounted for in the $26/SF net effective office rent he used in his calculations. (More than two years after the owner submitted the original Income/Expense statements for 1990, and even longer for the two prior years, the owner submitted amended Income/Expense statements. As with the originals, these were alleged to be accurate and complete. Mr. Hovermale testified that his review of them did not reveal differences substantial enough to change his valuation.) Mr. Hovermale derived an assessed value for the subject of $120 million.

6. Mr. Hovermale's review of comparable sales data supported his use of the 9.5% capitalization rate; in fact, the rates from the market showed a much lower rate than the one used. Further, the dollar-per-square-foot of net rentable area derived from the sales confirmed his value of $260.28/SF of net rentable area for this building containing approximately 461,045 square feet.

7. Petitioner first offered the testimony of Raji Shah, an assistant building manager, who said he prepared the amended statements. He also testified that he did not sign the forms submitted to the District nor did he have any records of the changed information he reported.

8. Petitioner next offered the testimony of Richard R. Harps, an expert appraiser, who testified in detail about his appraisal report. In his valuation of the subject, Mr. Harps stated he deducted $604,200 for tenant concessions and $238,000 for leasing commissions. He testified he included these deductions because they were justified and typical for the market. In his development of his capitalization rate, he first reported three comparable sales whose overall rates, including the tax rate, averaged approximately 6.7%. Mr. Harps ignored these, however, and relied on industry publications that gave national rates, national mortgage commitments, life insurance industry data, and investor surveys. Mr. Harps concluded that the basic overall capitalization rate from the market was 8.25%, and the combined capitalization rate was 10.4% when the tax rate of 2.15% was added. Dividing this into his projected net operating income of $10.6 million developed

his value of $102,400,000, rounded.

9. Under cross-examination, Mr. Harps conceded several important points. He admitted that the amounts he used for tenant concessions and leasing commissions appeared nowhere on any of the original or amended Income/Expense forms submitted by the owner, or in the financial reports prepared for the corporation by an independent audit firm. He stated he was "told" they were accounted for in the audit reports, but admitted he could not show where they appeared. Likewise, he was unable to show amounts totalling $842,200 (or even close to this amount) anywhere on the forms sent to the District.

10. Under further cross-examination, major shortcomings were revealed with the industry reports upon which he relied to develop his capitalization rate. Mr. Harps acknowledged he knew nothing of the properties used either in the national market survey or life insurance council survey—what types of properties, where located, if comparable to subject property, their condition or age—crucial data to know for meaningful use in developing capitalization rates. He also admitted knowing nothing specific about the investors surveyed in the other reports he used.

11. When questioned about the comparisons he initially used between the three comparables and the subject, Mr. Harps stated that the overall rates he provided were "before the addition of the tax rate." He valued the subject at $227/SF of net rentable area, substantially below the $229/SF to $264/SF of net rentable area of any of the three comparables, despite the subject's significantly

greater $23.78 net rent/SF of rental area (before the real estate tax payment) as compared with the much lower range for the comparables of $15.82 to $17.46 net rent/SF of rental area (also before the real estate tax payment). Not only did Mr. Hovermale clearly refute this analysis, Mr. Harps' appraisal report confirms the assessor's statements. In his discussion on page 94, Mr. Harps uses the term "overall rate" as comprising the "basic overall rate and the tax rate," precisely the reasoning to apply to the "sale overall rate" he shows for the comparables in the chart on that page. This confirms Mr. Hovermale's value of $260/SF of net rentable area as accurately reflecting the value for the subject property.

Conclusions of Law

This court has jurisdiction over this matter pursuant to D.C. Code §§47-825 and 47-3303 (1990 Repl.). The Superior Court's review of a tax assessment is de novo, which necessitates competent evidence to prove the issues asserted. Wyner v. District of Columbia, 441 A.2d 59, 60 (D.C.App. 1980). Petitioner bears the burden of proving that the assessment appealed from is incorrect. Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C.App. 1987). Petitioner has not met this burden.

To determine the assessed value for tax year 1993, Mr. Hovermale, the assessor, relied upon the income approach, and used the comparable sales to support his overall value. Based upon an analysis of the Income/Expense and rent roll data supplied by the owner, the assessor determined an economic net operating income.

The Department calculated the capitalization rate range appropriate for tax year 1993 assessments from 1990-91 sales of Central Business District properties, with assessors using income/expense data on each property to develop individual rates. Based upon this analysis, a range of 9.25-11.0% was established, from which Mr. Hovermale selected 9.5% as appropriate for the subject. Supported by data from the market, a value of $120 million was established for the subject property.

Mr. Hovermale's analysis was not arbitrary, and the court found his testimony and documentation credible. In his testimony explaining the development of his assessed value, Mr. Hovermale explicitly considered, as required by statute, the matter of equalization—ensuring that the property tax paid by one owner is no more or less than that paid by the owners of similar properties. Based upon the evidence presented, this court finds the assessor's value supported, and that petitioner has failed to prove the assessment appealed from is incorrect.

In evaluating the appraisal report prepared by petitioner's expert, and his testimony, this court notes the inconsistencies and the absence of support for the conclusions of Mr. Harps. Particularly in the three areas he indicated problems with the assessor's value, the court found Mr. Harps' testimony unpersuasive. Mr. Harps was provided no evidence of the amounts for tenant concession and leasing commission costs he deducted from his net operating income; these figures appeared nowhere in the original or amended Income/Expense reports or the audited financial

statements of the corporation. His only evidence referred to what others "had told him." Even crediting his testimony, Mr. Hovermale deducted an amount, $1.8 million, more than double the $840,000 Mr. Harps used.

As Mr. Harps' own appraisal report demonstrates, he was wrong in disputing the capitalization rate data from the sales he used and the subject property. He simply ignored the market, and relied instead on various national survey data whose reliability and relevance, particularly as related to office buildings in the Central Business District, he testified were completely unknown to him. Further, Mr. Harps' value of $224/FAR greatly undervalues the subject, as shown again by the comparable sales he used which sold at substantially higher values although averaging more than $6/SF of net rentable area less than the subject's $23/SF. As a consequence, these inconsistencies in his testimony weakens his conclusion of value, and the court places little credibility on the analysis reflected in Mr. Harps' testimony or appraisal report.

For these reasons, the court finds the rationale for the conclusions reached by Mr. Hovermale, the assessor, and other evidence supporting his position persuasive and accepts them, and rejects the analysis and conclusions of petitioner's expert. Accordingly, the court finds support for the assessed value of the subject property of $120,000,000 for tax year 1993, with $57,953,194 allocated to the land and $62,046,806 allocated to improvements.

Therefore, it is by the court, this ____ of _____ 1994,

ORDERED that the estimated market value of the subject real property for tax year 1993 is $120,000,000, with $57,953,194 allocated to the land and $62,046,806 allocated to the improvements.

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J U D G E

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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

NATIONAL PRESS BUILDING CORP.	:	
Petitioner,	:	
v.	:	Tax Docket No. 5750-93
DISTRICT OF COLUMBIA	:	
Respondent.	:	

MEMORANDUM OPINION AND JUDGMENT

This matter came on before the Court upon the Petition for a partial refund of real property taxes for Tax Year 1993. The realty in dispute is, as a practical matter, an office building known as the National Press Building. It's principal tenant is the National Press Club.

One of the critical issues at trial was the significance of the property's history in attempting to service the unique tenant population of this building. The Court is required to examine closely the income and expense experience of the property in determining whether the District of Columbia incorrectly assessed taxes.

A trial de novo was conducted before this Court. Upon consideration of the petition, the evidence adduced at trial, and having resolved all questions of

credibility, the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. The parties stipulated to the following facts at Pre-trial:

(a) Petitioner is the owner of Lot 53 in Square 254, together with the improvements thereon, with a street address of 529 14th Street, N.W.;

(b) The amount of tax in controversy is $2,414,770, representing the real property tax for which Petitioner was billed for the 1993 tax year. This includes the period beginning July 1, 1992 and ending June 30, 1993. Petitioner paid the 1993 real property taxes under protest, in two equal installments on September 15, 1992 and March 31, 1993;

(c) Petitioner filed an appeal of the assessment for tax year 1993 with the Board of Equalization and Review on or about April 15, 1992. The Board rendered a decision reducing the proposed assessment for the Property from $120,000,000 to $112,314,886.

2. The tax assessor for tax year 1993 was Mr. Larry Hovermale. Mr. Hovermale is a commercial assessor with the Department of Finance and Revenue ("Department") of the District of Columbia. For tax year 1993, Mr. Hovermale testified that he relied upon

the income approach to value, with some consideration given to the comparable sales approach. The District's overall assessment of this property for tax year 1993 was $120,000,000, with $57,953,194 allocated to the land and $62,046,806 allocated to the improvements.

3. Mr. Hovermale did not perform an inspection of the building in connection with his assessment for tax year 1993. Furthermore, he did not make an independent determination as to the land value of the property for tax year 1993 (i.e., that component of the total assessment attributable to land as opposed to the improvements). Instead, with respect to the land value, he accepted a directive developed by the Office of Standards and Review, Department of Finance and Revenue, which simply reduced the value assigned to the land from the prior tax year, tax year 1992, by a certain percentage.

The percentage reduction applied was namely approximately eighteen percent (18%). He had no knowledge as to how this directive was developed or on what basis the eighteen percent (18%) calculation was made. Since he did not recall having been involved in the assessment of the property for any prior tax year, he was unable to testify as to the correctness of the assessment of the land value for tax year 1992 from which the eighteen percent (18%) reduction was taken.

4. At trial, Mr. Hovermale acknowledged that the property is unique in that the building, for the most part, is divided into many small suites occupied by a very large number of tenants, specifically **in excess of 300 tenants**. In addition, he testified that, based on his examination of the leases for the property, the terms of the leases (i.e., their duration) were **shorter** than typical lease terms for commercial tenants in the market.

5. The analytical model through which the assessment was made is commonly known as the "capitalization of income approach," or simply the income approach. It basically involves two steps: (1) determining the net operating income ("NOI") of the property and (2) dividing that figure by a capitalization rate.[1/]

Using the income approach, the assessor assumed a net operating income of $11,299,962. This amount was determined by applying so-called "economic" income and expense data which he selected from the Pertinent Data Book provided to him by the Division of Standards and

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[1/]There are two other models that are used in the appraisal of commercial property: (1) the "replacement cost approach" or "cost approach," and (2) the "comparable sales approach" or "sales approach." In the instant case, both the assessor and the Petitioner's expert appraiser employed the income approach. Thus, the selection of the appraisal method is not a bone of contention in this particular litigation.

Review within the Department of Finance and Revenue.[2/] Mr. Hovermale had no knowledge whether the data provided by the Office of Standards and Review was "median" or "typical" data.

Mr. Hovermale did not base his estimated value on the actual income and expenses of the property. It is apparent that each year, commercial taxpayers file Income and Expense forms with the Department. This information is filed a short time after the assessment date itself. In the instant case, the assessor did not have available to him (on the date of the assessment) the Income and Expense form that related to calendar year 1992. However, he did have access to the forms for calendar years 1989, 1990, and 1991, if he had cared to use them. The forms for those years were corrected in 1994, prior to trial. See further discussion, infra.

6. The assessor used a capitalization rate of nine and five-tenths percent (9.5%). This capitalization rate was also selected by him from the Pertinent Data Book. The determination to select this capitalization rate was due in part to an agreement between Mr. Hovermale and other assessors within the Department to apply the same rates to properties

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[2/]Traditionally, the term "economic" refers to what is being observed in the marketplace generally -- not what is actually occurring with one particular property.

located in what is known as the Central Business District ("CBD"). He acknowledged, however, that, of the approximately 180 buildings in the CBD for which Mr. Hovermale had assessment responsibility for Tax Year 1993, **none** were comparable to the subject.

7. For tax year 1993, the assessor essentially used data derived from other properties provided to him by others in the Department. He then made a mathematical calculation to determine the assessed value of the subject property from such data provided to him. The District of Columbia offered no testimony except that of Mr. Hovermale.

8. The Petitioner presented its case in chief through the testimony of two witnesses, Mr. Rajiv Shah and Mr. Richard R. Harps, MAI. Mr. Shah testified that he has been the assistant property manager for the property since 1990. He identified income and expense forms submitted to the District of Columbia for the property for calendar year 1989 (Petitioner's Exhibit 1,) 1990 (Petitioner's Exhibit 2), and 1991 (Petitioner's Exhibit 3), which were admitted into evidence. He then identified Revised Income and Expense Forms dated May 6, 1994 (Petitioner's Exhibit 4), which were filed with the District of Columbia after May 6, 1994, but prior to the trial of this case. Mr. Shah explained that the reason for the filing of

Petitioner's Exhibit 4 was his discovery that certain information contained in the original forms filed by the prior management agent had not been accurately presented.[3/] He stated that the revisions reflected the actual experience of the property and were based on audited financial statements.[4/]

9. Mr. Richard R. Harps, MAI appeared as an expert witness on behalf of Petitioner. Respondent stipulated to Mr. Harps' qualifications as an expert. His qualifications are set forth on page 102 of his appraisal report, admitted into evidence as Petitioner's Exhibit 5.

In the opinion of Mr. Harps, the value of the property for tax year 1993, as of January 1, 1992, was $102,400,000, of which $45,000,000 was attributable to the value of the land and $57,400,000 was attributable to the value of the improvements.

10. In order to make his appraisal of the property, Mr. Harps, inter alia, analyzed the neighborhood, made a full inspection of the building,

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[3/]It was relevant for the Petitioner to offer the testimony of Mr. Shah as a prelude to the testimony of Mr. Harps, the expert. This is because Mr. Harps utilized the amended Expense and Income forms, not the old ones, in performing his appraisal.

[4/]Mr. Shah had discovered the errors himself. They included mistaken information on various items, one of which was the category of "vacancy and credit loss." The District raised no challenge to Shah's reasons for making the corrections. His testimony is not rebutted.

reviewed the floor plans of the finished levels of the building, studied the zoning applicable to the property, performed an analysis of office market trends and analyzed the economy in the CBD and the Washington metropolitan region. He described the property as a part 13 and part 14 story, plus basements, mixed use retail and office building containing 457,243 square feet of rentable area.

Based on the Annual Leasing Report for 1991, there are 349,489 square feet of net rentable area of office space, 61,010 square feet of net rentable area of retail space and 46,744 square feet of net rentable area occupied by the National Press Club. The retail space consists of an interior mall on three levels which is connected to the group of stores and service providers known as the "Shops at National Place," but which is not connected to the food court at the Shops.

The National Press Club occupies the 13th and 14th floors of the subject building and was described as a major "draw" (i.e., attraction) to the building, as the leading center for press activity in the District of Columbia. Journalists from all over the United States and the world work and congregate in this portion of the building. The property was renovated during the early 1980s.

With respect to the economy as of January 1, 1992, Mr. Harps stated that the region was in the grips of a recession and that the severe overbuilding by the real estate industry and the movement away from public sector employment combined to make the effects of the recession more severe than anticipated. As a result, effective office rents had declined dramatically by this time and vacancies had increased substantially.[5/]

11. In addition to the incomparable National Press Club which occupies two full floors of the building, Harps testified to the following additional unique factors, **all** of which he believed affected the value of the property.

First, the median size of tenanted spaces in the building is 588 square feet and 118 tenants occupy less than 500 square feet each.[6/] Only **nine** (9) of 264 office suites contain 10,000 square feet or more.

The very large number of leased premises within the building and the small size of most of these premises were attributed to tenants such as news organizations, foreign correspondents, and video production facilities which were attracted to the

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[5/]Harps recalled that, during the 1980s, no one in the real estate industry thought that the building boom would stop. The continuation of the development of office buildings was the expectation of purchasers of commercial properties.

[6/]In the Court's view, this is extremely small.

building by the presence of the National Press Club and the communications, broadcasting and other facilities offered by the building.

Second, Mr. Harps further stated that, of the large number of spaces occupied by small tenants, many have no windows. He stated that the leases also tend to be short-term leases, specifically 1.9 to 3.4 years, as opposed to the typical term of commercial leases in the marketplace of five (5) to ten (10) years. He stated that these spaces were **constantly turning over and being reconfigured**, both of which generate an unusually high level of operating expenses to the property owner. Examples of such expenses are carpeting, painting, dry wall moving and refitting, re-shaping of offices, etc. Leasing costs were also higher than is typical in other buildings **because of the large turnover** of the office spaces.

Third, the National Press Building has unique expense obligations because it is in full operation 24 hours per day, 52 weeks every year because of the press functions of its tenants. Harps stated that, as a result of the around-the-clock operations, the owner is required to incur greater-than-typical operating expenses.[7/]

[7/]This Court draws the inference that, apart from the usual reconfiguration expenses, these circumstances make it virtually

(continued...)

As to retail space in the building, Mr. Harps testified that the rental received from the master tenant (The Rouse Company) declined for three years in a row (and specifically by over $500,000 between 1990 and 1991), and that the income received by The Rouse Company was insufficient to pay the rent due under the master lease to the building owner. As a result, the owner was forced to renegotiate the retail master lease.

With respect to the tenants' lease terms, Mr. Harps testified that, although rent discounts were largely nonexistent until January, 1991, they increased dramatically after such date. The overall trend in rents from January 1991 until 1994 was downward.

12. Mr. Harps testified that the income capitalization approach is the preferred approach in the market, is given most weight by market participants and is the primary approach utilized in the analyses of properties subject to leases such as the subject property. The income approach produces a value estimate based on analysis of a property's capacity to generate monetary benefits. This approach converts

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[1/](...continued)
impossible for the owner to economize by eliminating or seriously curtailing heat and air conditioning during nights, weekends, or so-called off-peak hours of tenant occupation. In the particular building, it is apparent that there is no such thing as "off hours" or "off peak" hours. Clearly, this particular tenant population needs all building services at all hours.

such benefits into an indication of present value. Mr. Harps testified that, for the reasons above, most reliance was placed on the income approach.

13. In applying the income approach to the subject property, Mr. Harps estimated the fair economic rent for office, retail and storage space within the subject property. According to him, the best indication of fair economic rent for a property is the **actual** recent rent achieved in the building itself. Therefore, Mr. Harps undertook an extensive analysis of the income generated by existing office leases within the building (exclusive of the National Press Club because of its affiliation with the owner).

By analyzing such leases, and particularly the trends in leases signed in 1989, 1990, the first half of 1991 and the second half of 1991, Mr. Harps determined that the fair economic rent for the leased spaces which were expiring and vacant space within the building was a weighted average of $29.36 per square foot. This amount is five percent (5%) less than the rentals which the property was able to command in the second half of 1991 because of the downward trend in rents over the three year period 1989-1991. By combining such calculations with the actual office rent produced by then existing (i.e., on-going tenancies),

gross office potential rental was estimated to be $12,070,659.

14. For the retail space, Mr. Harps projected a fair economic rental rate of $18.00 per square foot, which he indicated was greater than the rate per square foot actually collected by the owner in 1991. In determining such fair economic rent, the expert witness also utilized three comparable retail leases from other properties. Mr. Harps added to his fair retail rent assumptions the income produced by pass-throughs of expenses and taxes.

15. Mr. Harps concluded his income analysis by analyzing and determining storage rent, fair market rent for the National Press Club, rent from delivery kiosks and antennas, as well as escalation and miscellaneous income. Based on his analysis, he determined gross potential income of the property as of January 1, 1992 to be $15,816,228.

Mr. Harps based his income projections primarily upon the property's experience, although, with respect to the retail space, he conservatively projected a rental rate which exceeded actual collections.

16. From the gross potential income estimate, Mr. Harps made adjustments for vacancy and credit loss, rent abatement, build-out allowances and other tenant concessions. His total deduction for such purposes

applicable for tax year 1993 was $632,649 for vacancy and credit loss and $604,347 for "free rent" and tenant build-out costs.[8/]

17. Having determined gross potential income and tenant vacancy, credit loss and other appropriate adjustments, Mr. Harps analyzed the expense history of the subject property over the three year period from 1989-1991. This examination was undertaken by each expense category (i.e., management, leasing commission, utilities, etc.). He also compared the actual expenses of the building to expenses of over ninety (90) other office buildings in the District of Columbia, particularly other buildings which were (i) multi-tenanted, (ii) full service buildings containing over 200,000 square feet of net rentable area, and (iii) constructed or renovated within the past 3 to 10 years.

Based on his analysis, Petitioner's expert witness determined stabilized expenses for the property to be $8.09 per square foot, which total $3,927,601, and concluded that such expenses were within the general range of comparable expenses from the other buildings.

[8/]So-called "free rent" for a certain period of time is a common concession that is offered to tenants as an enticement to sign a lease. It is a normal marketing tool and is recognized as a legitimate expense or cost of doing business.

18. Mr. Harps then calculated a net operating income by deducting from the effective gross potential income of the property (i) the adjustments for vacancy, credit loss and tenant concessions and (ii) stabilized expenses. Such net operating income ("NOI") was determined to be $10,651,631.

19. Having calculated the building's NOI, Mr. Harps analyzed relevant data to determine a capitalization rate.

He first analyzed data from sales of other properties, but determined such rates were inappropriate or unreliable for the subject property because they were from transactions with a much greater "upside" (i.e., future revenue potential) or were based on data that was difficult to qualify or verify. Instead, he relied on data from several recognized sources, including publications of the American Institute of Real Estate Appraisers, the American Council of Life Insurance, and the Korpacz Real Estate Investor Survey. Such sources indicated overall capitalization rates for the CBD in the District of Columbia to be between 6.5% and 11%, with most relevant data indicating rates of approximately 8.1% to 9.5%. The subject property, he testified, lacked "upside" potential because of the recent lease turnovers which resulted in reduced rental rates, reduced retail rent

from the master retail tenant, and an office vacancy rate which creates little potential for rental increases.

He concluded that the subject property was highly stabilized (i.e., there was little potential for "upside" increased revenues or "downside" risk) and that a lower capitalization rate was inappropriate, specifically because of the lack of upside potential. Based on his analysis, he determined the appropriate capitalization rate to be 8.25%. With an adjustment for the real estate tax rate of 2.15%, the combined capitalization rate used by Mr. Harps was 10.4%.

20. Mr. Harps, as confirmed in his appraisal report, points out that the 9.5% capitalization rate used by the assessor is too low and inappropriate for application to a building such as the subject property which has such a high degree of stabilization and which therefore will not achieve significant increases in net income in the future.

21. Mr. Harps applied the capitalization rate to the NOI as of the valuation date to arrive at a final value for the subject property of $102,400,000.

22. Mr. Harps testified that he determined a valuation for the land, the improvements, and the property as a whole. With respect to determining a value for the land, he selected four sales of land in

the vicinity of the site, adjusted such sales for relevant differences (including time, location, size and corner), and further adjusted such sales for the adverse impact of certain Downtown Development District/Shop zoning ("DDD/Shop") impediments to value.

With respect to such zoning controls, Mr. Harps testified that it is doubtful anyone would build a building on the site if it were vacant because of the adverse effect of the DDD/Shop zoning restrictions.[9/] Based on this analysis, he determined a land value of the property for tax year 1993 to be $45,020,700. Mr. Harps then rounded this estimated value to $45,000,000 to produce his expert opinion of the value of the land as of January 1, 1992.

23. The current use of the property as presently improved represents its highest and best use.

The District of Columbia failed to call any expert witnesses to refute the reasoning and methodology of Mr. Harps. The record does not disclose why the District did not offer any competing expert testimony.

Conclusions of Law

This Court has jurisdiction over this appeal pursuant to 47 D.C. §§ 825 and 3303 (1981). The

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[9/]He observed that the local over-supply of retail space makes the off-grade retail space not particularly valuable or enticing to a potential purchaser. The term "off grade" refers to area that is not at sidewalk level. This description does indeed characterize much of the retail space in the Shops.

Superior Court's review of a tax assessment is de novo, which necessitates presentation of competent evidence to prove the issues. Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. 1980).

Real property taxes are based upon the estimated value of the subject property as of January 1st of the year preceding the tax year. 47 D.C. § 820 (1981). "Estimated market value" is defined as:

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

47 D.C. § 802(4) (1981)

To determine the estimated market value of a property, the District must take into account factors bearing on that subject, including but not limited to, sales information on similar properties, mortgages or financial considerations, reproduction cost less accrued depreciation, condition, income earning potential, expenses, zoning and government restrictions. 47 D.C. § 820(a). The factors to be considered in determining value as outlined in the

statute relate to current circumstances or to those reasonably probable in the future.

Petitioner bears the burden of proving that the assessment appealed from is incorrect. Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987); Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986). Petitioner can meet this burden by demonstrating that the valuation of the subject property by the assessor was "flawed." Id. Petitioner has met the burden.

Flaws in the assessment are seen in three primary respects. One, the land portion of the assessment was derived arbitrarily and is not correct. Two, the assessor's NOI is not correct because it did not recognize the unique expense and income experience of this stabilized property. Three, the assessor's capitalization rate was not sufficient to cover the economic factors that are prescribed by current case law. Each of these flaws is addressed more fully as follows.

First, the assessor made **no** independent valuation of the land. At trial, he could not account for the underlying correctness of the value that he assigned to the land. He arrived at a land valuation by doing nothing more than reducing the prior year's assessment by 18%. He could not explain the substantive

underpinnings of this percentage -- stating only that he had been told to use it. This is not an assessment; it is mere arithmetic.

In characterizing the land valuation as a "flaw" in the overall assessment, it is important for this Court to elaborate on why it is a flaw, in the context of a trial de novo. Based upon what it contained in the trial record, the land assessment is effectively nothing more than an arbitrary number that leaves the Court with no way to probe the reasons that generated the 18% reduction and no way to gauge whether those reasons were logical or factually supportable.

The evidence produced by the Petitioner certainly makes a prima facie case that the District's land valuation is not correct, both because it is unexplained in substance and because other, more detailed expert testimony portrays a specific and practical analysis of what this land was worth on the valuation date.

Where the Court's factfinding role is concerned, it is important to observe that in response to the prima facie showing, the Government failed to produce any witnesses who might have been in a position to fill the void of information. In other words, the Government failed to call any witness to demonstrate that the arbitrary land value was nonetheless

justifiable, even if the assessor could not shed light on the subject. Such witnesses might have included officials from Standards and Review who could have reconstructed the genesis of the 18% reduction -- or an expert witness who could have appraised the land independently as a check on the figure that the assessor gave as a valuation.

The lack of a factual basis for the land portion of the assessment means that a well-explained, detailed appraisal by an expert will deserve greater credibility and evidentiary weight.

In light of what the trial record reveals, this Petitioner has carried its burden of showing that the original assessment as a whole was incorrect. The unjustified land valuation is merely one of several different reasons as to why it was incorrect. Even if no issue had been raised concerning the land, this Court must reject the assessment as a whole for separate reasons that relate only to the value of the improvements, i.e. the building.

Second, the assessor's NOI was incorrect because by totally ignoring the experience of the property he missed the pivotal **uniqueness of the subject property** and the trends of its expenses. This occurred even though he was personally aware of the unusually large number of tenant spaces and the unusually small size of

most of them. Having to make specific calculations based upon the actual experience of the property would have forced the assessor to work with meaningful figures, rather than ignoring even basic facts that he casually knew but discarded.

The fundamental decision to ignore actual data on this property was a decision that automatically consigned the assessor to use financial information that could not capture the most pertinent signs as to what the property was actually worth and where this property was going as far as its future income stream was concerned.[10/]

A good working knowledge of the income and expense **trends**, as such, are important to the derivation of income earning potential. After all,

> [t]he fundamental notion that the market value of income-producing property reflects the 'present worth of a future income stream' is at the heart of the income capitalization approach. 16 DCRR § 108(b)(3); 9 DCMR § 307.5. . . .

District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 115 (D.C. 1985). In fact, "[w]hen an income producing property has been in operation for a period

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[10/]In criticizing the assessor's exclusive reliance upon so-called "market" data in determining NOI, Mr. Harps noted that market rents tend to be linked to rentable spaces that are larger than the offices that typify the tenanted portions of the National Press Building. Thus, the market data would tend to be misleading in this case.

of time, its past earnings assist the assessor in projecting future earning ability." Id.

This Court concludes that the National Press Building is a classic example of the kind of building to which the Court of Appeals was referring in the above-quoted passage. Moreover, without literally saying so, it is evident that with a fully stabilized property, such as the National Press Building, the Court of Appeals assumes that assessors are indeed using actual earnings data from the subject property.[11/]

Petitioner herein highlights the assessor's lack of knowledge about this office building. For example, Mr. Hovermale testified that he had "heard of" the National Press Club but admitted that he personally did not know anything about the business or purpose of the organization. This is difficult to reconcile with his other claim that he was indeed aware that most tenants in the property were journalists. Although the assessor's testimony reflects a surprising lack of

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[11/]In the instant case, the record reflects that the amended Income and Expense forms for prior calendar years do show larger figures for certain expenses. However, to the extent that these particular forms were not available to the assessor on the valuation date, this is not to be held against the Government. The point to remember is that the assessor still would have gained vital information about the expense and income trends themselves if he had made use of the old forms that were already on file. The same basic pattern of expenses and income did not change because of the amended forms.

understanding about a rather famous entity in the District of Columbia, the real issue is not his personal familiarity with the tenants. Rather, the real issue was his decision not to examine and rely upon the actual experience of the property in conjunction with any other market research that he deemed relevant.

Under the totality of circumstances in the instant case, total reliance upon market data alone does not and cannot provide the critical information about the true milieu of this property.

Third, the capitalization rate used by the assessor was fatally flawed. The following considerations are important to understanding why this is so.

The capitalization of income approach requires that stabilization of annual net income (generally 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. According to the District of Columbia Court of Appeals, the correct execution of this analysis means that the capitalization rate is

> 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.

Rock Creek Plaza-Woodner Ltd. Partnership v. District of Columbia, 466 A.2d 857, 858 (D.C. 1983).

To be sure, the appellate court's recognition of what the capitalization rate must satisfy is a fundamental principle that governs this Court's decisionmaking. Moreover, the factors enunciated in Rock Creek Plaza and quoted herein above must be taken into account by the assessor, as well as any expert testifying at a trial de novo.

The assessor's capitalization rate does not comply with the requirements of Rock Creek Plaza. It is too low to cover a fair return on the investor's equity, because it ignores the unique expense of this property and the trends that flow from the apparent permanency of these circumstances. The capitalization rate used by the assessor (9.5%) is clearly unrealistic. The rate developed by Harps is thoroughly justified and in compliance with Rock Creek Plaza. Further discussion on this point is useful.

There is a direct and unmistakable connection between the income and expense history of this building and the capitalization rate that is necessary to account for a return on equity. The whole problem of annually paying for the incessant reconfiguring and redecorating of this beehive of small offices is a factor that would have significant impact on the "most

probable price" at which this property could be sold "in the open market."

This Court focuses upon the "annual" nature of the expense profile of this property because the appellate definition of a capitalization rate speaks directly of a rate that represents "the percentage rate that taxpayers must recover annually" to pay the mortgage, etc. The emphasis must be on the longterm.

Commercial tax assessments are intended to represent the most probable price that a willing buyer would pay for a property as of the valuation date. In determining what would be important to a willing buyer who is "seeking to maximize" gains or profits, nothing could be more critical than the candid recognition of what it takes to operate this office building. This is especially true where, as here, the property is stabilized.[12/]

What is under scrutiny here is the proper evaluation of the future income earning potential of this property, not the mere totaling of earnings for a particular year. See Wolf v. District of Columbia, 597 A.2d 1303, 1309 (D.C. 1991).

Without question, in the case of the National Press Building, no reasonable buyer (in considering

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[12/]An example of an unstabilized office building is one that is new, not substantially occupied, and still going through its initial "lease-up" period.

whether to purchase the property) would fail to heed the unusual costs of accommodating the turnstile groups of tenants, as it affects "the present worth of a future income stream." Deriving this present worth is "at the heart of the income capitalization approach to valuing commercial real estate." Id.

In the future, it is reasonably probable that there will be a continuation of the very same unique features that were set forth by Mr. Harps, as well as a continuation of their impact on the operational expenses of the building. The pattern is set.

Applying the net operating income and the capitalization rates determined herein to be appropriate by a preponderance of the evidence, the Court concludes that the subject property had an estimated market value of $102,400,000 as of January 1, 1992.

In stating a value of a commercial property for assessment purposes, an allocation must be made between land and improvements. 47 D.C. § 821(a) (1981). Petitioners expert witness concluded that the value of the land was $1,019.53 per square foot as of the valuation date. This Court credits his appraisal. Therefore, $45,000,000 should be allocated to the value of the land for the 44,138 square feet of land area for tax year 1993 and the Court accepts such valuation as

having been established by a preponderance of evidence. The remaining portion of the total valuation is allocated to the value of the building.

Finally, the Court must reject the Government's contention, stated during closing arguments, that the land portion of the assessment (and the Petitioner's challenge to it) is in the Government's words "irrelevant." The Government mistakenly relies upon the appellate decision in The Washington Post Co. v. District of Columbia, 596 A.2d 517 (D.C. 1991). That case is inapposite. The following discussion illustrates the difference between Washington Post and the instant case.

The law is clear that a taxpayer is entitled to a refund when the assessment of the "'real property' -- the combination of land and improvements -- is excessive, not when the allocation of value between land and improvements is erroneous." Id. at 520. Equalization is an important statutory goal of our local system of commercial taxation. "It would be entirely contrary to this concern for equity, however, to hold that a misallocation of value between land and improvements requires a refund even though the assessment as a whole is fair and accurate." Id. at 521.

The problem in Washington Post was a classic example of a situation in which the value allocated to the improvements was too high only because the assessor erroneously assumed that the improvements accounted for almost twice as much square footage as was true.

The assessor agreed, in his trial testimony, that the real value of the property was in the land and that if he "'had to do it all over again'" he would have allocated "'almost 95 or 98 percent in the land.'" Id. at 518. In other words, there was an admitted "misallocation" of value as between land and improvements. The assessor did not change his view as to the total value and the trial judge ultimately denied the petition for refund. The Court of Appeals agreed that there was no basis for rejecting the assessment as a whole.

Categorically, this is not the kind of scenario presented in the instant case. The problem at hand has no connection to misallocation, as such.

Where the National Press Building is concerned, the lack of sufficient factual basis for the land part of the assessment is relevant for two different reasons. First, since the Petitioner bears the burden of proving that the overall assessment is not correct or that it was improperly calculated, Petitioner is clearly entitled to raise issues with respect to any

flaw as to land **or** improvements. Second, the superficial method by which the land assessment was made is, as an evidentiary matter, very relevant to the court's evaluation of the weight that should be accorded the assessor's testimony. It goes to his ability to perceive what is important, as well as to his overall thoroughness and attention to important factors.

Under the totality of circumstances in this trial record, the testimony concerning the development of the land value, such as it was, is clearly not irrelevant.

For all of the reasons stated herein, Petitioner is entitled to the refund that is demanded. It is therefore by the Court this 16th day of June, 1995,

ORDERED, ADJUDGED and DECREED as follows:

1. That the estimated market value for the subject property is determined to be as follows:

	Tax Year 1993
Land	$ 45,000,000
Improvements	57,400,000
Total	$102,400,000

2. That the assessment record card and all other records for the property maintained by the Respondent shall be adjusted to reflect the values determined by this Order.

3. That Respondent shall refund to Petitioner excess taxes collected for tax year 1993 in the amount of $211,187.29 resulting from an assessed value which is in excess of the value determined by this Order.

4. That judgment be and the same is hereby entered in favor of Petitioner and against Respondent in the amount of $211,187.29, with interest thereon at the rate of 6% per annum from March 31, 1993, and costs.

Cheryl Long
Associate Judge

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