

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

JAN 3 5 19 PM '00

**FILED**  
DEC 31 5 17 PM '99

**SQUARE 345 ASSOCIATES  
LIMITED PARTNERSHIP, et al**  
TAX DIVISION

SUPERIOR COURT OF THE  
DISTRICT OF COLUMBIA  
TAX DIVISION  
**Tax Docket No. 8709-95**

v.

**DISTRICT OF COLUMBIA**

**ORDER**

This matter came before the Court for trial on the Petitioner's appeal from an assessment of real property taxes in Tax Year 1995 on an office building known as 1001 G Street, NW, Washington, D.C. The District's assessment of the real property is \$82,963,000. The Petitioner Taxpayer asserts that the value of the property is \$71,000,000. Upon consideration of the various pleadings, stipulations, testimony and evidence adduced at trial, the applicable law, and the record herein, this Court makes the following:

**FINDINGS OF FACT**

1. The subject property is owned by Square 345 Associates Limited Partnership Centerrock Limited Partnership, General Partner, a limited partnership organized and existing under the laws of the District of Columbia. The Petitioner maintains its principal place of business in the subject property.
2. The Petitioner, Square 345 Associates, is obligated to pay all real estate taxes assessed against the subject property.

3. The subject property is located at 1001 G Street, NW, Square 345, Lot 41, in the District of Columbia. It is improved by a twelve-story office building, built in 1987-1989, with five levels of underground parking and includes the shell of the former nine-story McLachlen Building with new interior. The property has a finished gross building area of 393,822 square feet and a net rentable area of 345,305 square feet. The property has 333,822 square feet of office space and 15,457 square feet of rentable retail space. The property also has 31,675 square feet of storage space, a 9,438 square foot exercises facility, and approximately 500 parking spaces. The property is zoned C-4, located in the Downtown Development District, and is developed to the Floor Area Ratio (FAR) of 10.0.<sup>1</sup>
4. For Tax Year 1995, the valuation date being January 1, 1994, the District's proposed assessment was \$82,963,000, allocating \$41,528,550 of the total value to land and \$41,434,450 of the total value to improvements.
5. The tax controversy for Tax Year 1995 is real estate taxes in the amount of \$1,783,704.50. The Petitioner timely paid the tax. The Petitioner timely filed a complaint with the Board of Real Property Assessments and Appeals (BORPAA). After a hearing, the BORPAA sustained the assessment. The Petitioner timely filed the petition for reduction of the assessment and refund of excess taxes paid for tax year 1995.
6. In its petition, the Petitioner asserted that the fair market value of the property for tax year 1995 was no more than \$66,597,000. At trial, the

---

<sup>1</sup> Floor Area Ratio is the relationship of the total gross building area above the grade to the land area of the site. If the land area and the building are equal, the FAR would be 1.0.

Petitioner asserted that the fair market value of the property was \$71,000,000, the figure calculated by the Petitioner's expert appraiser.

7. The Court heard sworn testimony from Rochelle Washington, Phillip Applebaum, and Troy Davis, tax assessors for the District of Columbia; Harry Horstman, expert witness for the Petitioner; and Ryland Mitchell, expert witness for the District.
8. The tax assessor for the subject property for Tax Year 1995 was Rochelle Washington, a commercial assessor with the Department of Finance and Revenue of the District of Columbia. Ms. Washington testified that she considered the income, sales, and costs approaches for valuing the subject property, but determined that the income approach to valuing the subject property was most reliable of the three approaches.
9. The capitalization of income approach, one of the three generally accepted approaches to the valuation of real estate, is based upon the amount that investors would be willing to pay to receive the income that the property could be expected to yield. 9 DCMR 307.5. In other words, the present value of the future benefits of property ownership is measured by capitalizing a property's income stream into a present, lump-sum value.
10. Troy Davis, an employee of the District's Standards and Reviews Division, is the individual responsible for developing the assessment factors, including the capitalization rate used by the District's assessor, Ms. Washington, to derive the assessment on the subject property. In his testimony, Mr. Davis cited various resources used to identify, ascertain the accuracy, and test the

reasonableness of the factors used to develop the capitalization rate. Those resources included income and expense reports filed annually by income producing (office) property owners in the District, sworn statements of commercial property purchasers and sellers filed with the Recorder of Deeds, realtors, real estate bankers, real property appraisers, assessors and other professionals in the field of office leasing, and various reports and journals including the *Investment Bulletin*, the *Korpacz Report*, *Appraisal News*, *Radcliffe Calli*, *Dumphrey & Hughes Company Report*, and *Valuation Viewpoint*.

11. In developing her assessment of the subject property using the capitalization of income method, Ms. Washington testified that she derived a stabilized net operating income (NOI) of \$8,271,381.00 by applying the rate of \$37.50 per square foot for office space to the net rental subject property, then applied to that figure a 9.97% capitalization rate.
12. Ms. Washington testified that the leases in place, as of the valuation date, indicated that the subject property had a gross potential income of \$9,128,797.00 or \$37.50 per square foot of office space. Ms. Washington testified that the leases were compared with the existing leases of other properties in the District of Columbia of comparable size, age, condition, and location, and that after her application of assessment factors "typical" for properties such as the subject property, she stabilized the subject property's net operating income, as of the valuation dates, at \$8,271,381.

13. The District's assessor, in computing the figures of the subject property, utilized assessment economic data compiled in the Pertinent Data Book. The Pertinent Data Book guidelines were derived from such sources as the income and expense reports filed annually by income producing property owners in the District, statements of commercial property purchasers and sellers filed with the Recorder of Deeds, realtors, real estate bankers, real property appraisers, and other professionals in the field of office leasing, and various reports and journals specializing in the leasing, sale, and management of commercial real estate. This table of rates was provided to the District's assessor, Ms. Washington, for use in calculating commercial property tax assessments, by the Standards and Review Division of the Department of Finance and Revenue.
14. The District's tax assessor, Ms. Washington, testified that the actual expenses, vacancy, and age of the subject property were similarly comparable to the performance of properties included in the guideline's "Category G," and that the expense, vacancy, and age factors applicable to "Category G" properties were factored to derive the assessment for the subject property.
15. Calendar year 1992 data was the most recent year available to Ms. Washington when she did the assessment of the subject property. The 1993 Income/Expense Reports and Annual Leasing Reports (Rent Rolls) for the subject property, submitted by the Taxpayer to the District of Columbia Department of Finance and Revenue, is for the 12-month period ending on

December 31, 1993. The 1993 report is signed and dated March 31, 1994.

The Tax Year 1995 valuation was performed with data available as of January 1, 1994.

16. The subject property includes 333,822 square feet of office space. As of the date of valuation, the office space in the subject property was 90% leased. Thus, the vacancy rate for office space was approximately 10%. Both the District's expert (Mitchell) and the Petitioner's expert (Horstman) suggest a 10% vacancy for office space in the subject property. The District's assessor, Ms. Washington, utilized an 8% vacancy rate.
17. The Court determines, as a finding of fact, that the average rate for leased office space, for purposes of this valuation, is \$30.12 per square foot.<sup>2</sup>
18. The subject property includes 11,478 square feet of retail space. As of the valuation date, the retail space in the subject property was approximately 48% leased. Thus, the vacancy rate for retail space was approximately 52%. For the record, both the District's expert (Mitchell) and the Petitioner's expert (Horstman) presented the figure of 52% as the rate of retail space vacancy in the subject property.
19. The Court determines, as a finding of fact, that the average rate for leased retail space, for the purposes of this valuation, is \$49.67 per square foot. At the time of valuation, only four retail leases were in place, covering a total of 5,496 square feet.

---

<sup>2</sup> This figure was calculated and submitted to this Court by the District's expert, Ryland Mitchell. The Court notes that the Petitioner's expert, Henry Horstman, determined a range of \$25.63 to \$31.34 per square foot for office space, but calculated only \$29.00 per square foot for the "west building" and only \$22.05 per square foot for the "east building." The 1992 Rent Roll, submitted to

## CONCLUSIONS OF LAW

In accordance with District of Columbia Code §47-820(a), the assessed value for all real property shall be the estimated market value of such property as of January 1<sup>st</sup> of the year preceding the tax year as determined by the Mayor. *See* D.C. Code §47-820(a). Estimated market value is defined as “100% 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. *See* D.C. Code §47-802(4). The Code further specifies that the “Mayor shall take into account any factor which might have a bearing on the market value of the real property including, but not limited to, sales information on similar types of real property, mortgage, or other financial considerations, reproduction cost less accrued depreciation because of age, condition, and other factors, income-earning potential (if any), zoning, and government-imposed restrictions.” D.C. Code §47-820(a).

The taxpayer must prove that the government’s assessments were incorrect or flawed. *See* Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986); Superior Court Tax Rule 12(b). The taxpayer has the burden to show a defect in the methodology underlying the District’s valuation. *See* YWCA vs. District of Columbia, 731 A.2d 849, 850 (D.C. 1999) (taxpayer has the burden of proving

---

the Department of Finance and Revenue by the taxpayer, shows an average office space rent per square foot of \$30.22.

anything “erroneous, arbitrary, [or] unlawful” in the assessments). Furthermore, the taxpayer’s burden is to show that the assessment is “incorrect or illegal, not merely that alternative methods exist giving a different result.” Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987).

The Superior Court shall hear and determine questions arising on tax appeal and make findings of fact and conclusions of law. It is within the trial court’s broad discretion to accept whatever elements of an assessment the court deems valid and to make any necessary adjustments required by the evidence adduced at trial. Square 345 Assoc. Ltd. Partnership v. D.C., 721 A.2d 963, 965 (D.C. 1998). Within this process, the court may credit whatever elements of the assessment it deems valid. Square 345 at 966. The Superior Court may affirm, cancel, reduce, or increase the assessment. *See* D.C. Code §47-3303. Where the Court finds that the District’s assessment is flawed, the Court must determine the correct estimated market value. *See* Brisker v. District of Columbia, 510 A.2d 1037, 1040.

#### ANALYSIS

In accordance with the ruling of the District of Columbia Court of Appeals, the government is given sizable discretion in “choosing the method or approach for an assessor to use in estimating the market value of a particular property. YWCA v. District of Columbia, 731 A.2d 849, 851 (D.C. 1999). In the instant case, the District’s assessor used the capitalization of income approach to value the property in question.



The capitalization of income approach to value is based upon the amount that investors would be willing to pay to receive the income that the property could be expected to yield. *See* 9 DCMR §307.5. In other words, the present value of the future benefits of property ownership is measured by capitalizing a property's income stream into a present, lump-sum value.

Under the capitalization method, an estimate of the subject property's net operating income is derived. The net operating income is then divided by a capitalization rate to yield an estimate of the property's value. The capitalization of income method of valuation can be summarized by the formula  $V = I/R$ , where "V" is the present value of the property, "I" is the annual income generated by the property, and "R" is the capitalization rate. District of Columbia v. Rose Assoc., 697 A.2d 1236-1237 n.1 (D.C. 1997). The capitalization rate ("R") is a percentage ratio between the annual income expected to be generated by a building and the price a ready, willing and informed buyer would be willing to pay for it in a given year. Id.

The Petitioner asserts that the (1) the assessor improperly projected a net operating income that was not stabilized; (2) the assessor utilized a flawed methodology to develop the capitalization rate; and (3) the land assessment was based upon flawed methodology by making unwarranted adjustments to the FAR rate and by failing to account for the Downtown Development District. The Court will now address the elements of the capitalization formula and the merits of the Petitioner's arguments, beginning with net operating income.

### Net Operating Income

The Petitioner asserts that in calculating the value of the property, the District's assessor used a flawed estimate of the building's net operating income. The Petitioner argues that the process utilized by the District to derive the net operating income was flawed in three (3) ways: First, the Petitioner alleges that the assessor failed to take into account the actual income, expenses, and vacancy rate of the subject property in 1992, the year of which most recent data was available to the assessor. Secondly the Petitioner argues that the assessor incorrectly applied the Pertinent Date Book Standards. Third, the Petitioner argues that the assessor's failure to adjust the estimated future income of the building resulted in an inflated net operating income estimate.

#### *Actual Income, Expenses and Vacancy Rate*

In developing her assessment using the capitalization of income method, the District's assessor, Ms. Washington, used an economic net operating income (NOI) figure of \$8,271,381. The Petitioner asserts that the actual net income for 1992, the most recent data available to Ms. Washington when she did the assessment, was \$3,439,576.

The District's assessor testified that the leases in place at the valuation date indicated that the subject property had a gross potential income of \$9,128,797. To this figure, Ms. Washington testified that she applied assessment factors found in the Pertinent Data Book to stabilize the property's net operating income at the \$8,271,381 figure. The Petitioner asserts that this method was flawed because it did not take into account the actual income to the property in 1992 of only \$3,439,576.

Furthermore, the Petitioner argues, the estimated costs to the property used by the assessor of \$7.20 per square foot, a figure derived from the Pertinent Data Book, were below the actual costs to the property in 1992 of \$8.03 per square foot.

Finally, the petitioner points out that the vacancy rate used by the assessor of 8%, a figure also from the Pertinent Data Book, is much lower than the 1992 vacancy rate of 54%.

The fundamental notion that market value of income-producing property reflects the present worth of a future income stream is at the heart of the income capitalization approach. District of Columbia v. Washington Sheraton Corp., 499 A.2d 109 (D.C. 1985); Wolf v. District of Columbia, 597 A.2d 1303 (D.C. 1991). The Court finds that, under the income method of valuation, the assessor's task is to estimate future income of the property that would be available to a potential buyer. "Estimated market value is not determined... by reference to income available to the property as of the assessment, but by reference to income earning potential." District of Columbia v. Washington Sheraton Corp., 499 A.2d 109 (D.C. 1985). Proper application of the definition of "estimated market value," found in D.C. Code §47-802(4), requires consideration not merely of actual earnings, but of an adjusted income figure reflecting a variety of factors (including the impact of current leases) that influence market value of the potential income stream of a building. Wolf, 597 A.2d at 1310. Actual earnings may be relevant evidence of a building's future income earning potential, but it is the future potential, not the current earnings themselves, that must constitute the basis for valuation. Wolf, 597 A.2d at 1309. Therefore, the District's assessor may take into account other factors

relevant to the estimation of future income, such as the income of comparable properties.

*Pertinent Data Book*

The District's assessor, in computing the figures of the subject property, utilized assessment economic data compiled in the Pertinent Data Book. The Pertinent Data Book guidelines were derived from such sources as the income and expense reports filed annually by income producing property owners in the District, statements of commercial property purchasers and sellers filed with the Recorder of Deeds, realtors, real estate bankers, real property appraisers, and other professionals in the field of office leasing, and various reports and journals specializing in the leasing, sale, and management of commercial real estate. This table of rates was provided to the District's assessor, Ms. Washington, for use in calculating commercial property tax assessments by the Standards and Review Division of the Department of Finance and Revenue.

The District's assessor, Ms. Washington, testified that she considered the actual leasing activity, actual expenses, vacancy, and age of the subject property in applying the Pertinent Date Book's Guidelines. Ms. Washington testified that the leases in place, as of the valuation date, at the subject property indicated that the subject property had a gross potential income of \$9,128,797, or \$37.50 per square foot of office space. Ms. Washington testified that the property's income stream was secured by durable medium-to-long term staggered leases of creditworthy and reliable tenants.

The District's assessor further testified that subject property leases were compared with the existing leases of other properties in the District of Columbia of comparable size, age, condition, and location. Ms. Washington testified that the \$37.50 per square foot contract office lease income and the \$31.50 per square foot net effective office income "matched" Category G of the Pertinent Data Book Guidelines. Ms. Washington further testified that the actual expenses, vacancy, and age of the subject property were similarly comparable to the performance of properties included in the Guideline's Category G, and that the expense, vacancy and age factors applicable to Category G properties were factored to derive the assessment for the subject property.

*Building Age*

The Court now turns to the "Category G" figures listed in the Pertinent Data Book, Plaintiff's Exhibit 4 and Respondent's Exhibit 4. Buildings in category "G" were built between 1985 and 1993. The subject property was built in 1987-1989, plus the shell of the former McLachlen Building with new interior. Thus, the subject property falls within the "age" range of Category G.

*Vacancy Rate*

The vacancy rate for Category G properties, in Tax Year 1995, is listed at 8%. This 8% vacancy rate was utilized by Ms. Washington, the District's assessor. The Petitioner asserts a vacancy rate of 54% in 1992. The Court finds, however, that the Petitioner's vacancy rate figure of 54% reflects retail space vacancies only. The Petitioner's expert reported that the property was approximately 89.24% leased in January 1994. The District's expert reported that the property was approximately

90% leased. Ms. Washington testified that the property was approximately 89% leased. Thus, the Court finds that the Petitioner has not shown that the "Category G" vacancy rate range of 8% was incorrect or flawed.

*Actual Income*

The Court now turns to the rental rate figures. The record shows that \$37.50 per square foot for office space, utilized by the District's assessor, is from the Pertinent Data Book Category G "high" range. The Petitioner challenges this figure and submits a report that the rental rate for office space in the West Building should be set at \$29.00 per square foot and \$22.00 per square foot in the East Building. The Petitioner Taxpayer's 1992 Rent Roll report, which would have been available to the District's assessor, shows an average rent of \$30.22 per square foot of office space.

The Court finds that the District's calculation of lease income is erroneous. The Court finds that the District assessor utilized the Category G "high" income range of \$37.50 without consideration for the actual office space rental rates. The Court notes that the Category G "mid" income range is \$31.00 per square foot, a figure that closely compares to the 1992 Rent Roll figure of \$30.22 for the subject property.<sup>3</sup> The Court finds that the District's assessor relied on "Category G" figures from the Pertinent Data Book without adjustment reflective of the subject property's actual figures and reasonable projections. Thus, the Court finds that District's assessment of the subject property's income is flawed.

---

<sup>3</sup> The Court notes that the District's assessor chose to use the "high" range for income, but chose the "mid" range for expenses.

Upon consideration of the expert testimony and reports, and the record herein, the Court finds that the report of the District's expert Mitchell to be the most credible on the point of rental rates and income. The District's expert (Mitchell) reports that the average rent per square foot for occupied office space was \$30.12. This figure closely compares with both the 1992 Rent Roll figure as well as the Category G "mid" range. In addition, the District's expert (Mitchell) calculated \$25.00 per square foot for 30,749 square feet of office space vacant at the time of valuation. The Court finds that earning potential for rentable space, although currently vacant, must be taken into consideration under the income approach. Thus, the total office space potential is \$9,897,522 with a vacancy loss deduction of 10% in the amount of \$989,752 for a sum of \$8,907,770 effective gross income for office space.

The Court finds that the District's expert's (Mitchell) assessment report to be most credible in that it considers actual figures and calculates reasonable projections, both of which are relevant to market value under the income capitalization approach. In his report, Mr. Mitchell considers: office space actual lease figures, vacant office space lease rate projections, and calculates a vacancy loss reduction of 10%; occupied and vacant retail lease rates and projections with consideration for the vacancy loss reduction of 20%; as well as storage, parking, and miscellaneous income, and operating expense pass-throughs.

The District's expert (Mitchell) calculated \$49.67 per square foot for 5,496 square feet of leased retail space and \$35.00 per square foot for 5,982 square feet as a more conservative projection for vacant retail space, for a sum of \$482,361 in

potential retail lease income. A vacancy loss deduction of 20% in the amount of \$96,471 was applied for an effective gross income for retail space in the amount of \$385,890. The Petitioner, through its expert, asserted that the retail space rate should be \$30.00. The Court finds, however, that the figure of \$49.67 reflects the actual lease rates with consideration for the annual step increases in base rent. In addition, the Court finds that the District's expert (Mitchell) appropriately considered operating expense pass-throughs of \$8.00 per square foot for office space and \$6.00 per square foot for retail space for a sum of \$1,270,560.00. Storage, parking, and miscellaneous income valuation amounts to \$800,000. Thus, the Court finds the Total Effective Gross Income for the subject property is \$11,364,220.

#### *Expenses*

The District's assessor utilized an expense rate of \$7.20, a Category G "mid" expense range. The Petitioner asserts that the expenses were \$8.03 per square foot. The Court finds that the \$8.03 figure is calculated by dividing the 1992 rent roll total expense of \$2,774,474.33 by the net rentable area of 345,305 square feet. The Petitioner's expert reported operating expenses in 1993 at \$8.76 per square foot. The District's expert projected \$9.00 per square foot in expenses when applied to the total 345,000 leasable square feet of improvements at the subject property.

The Court finds that District assessor's calculation of expenses at only \$7.20 for the subject property is erroneous. The Court finds that the District assessor utilized the Category G "mid" expense rate of \$7.20 without adjustment for the actual expenses of the subject property and with projection of future expenses.



Whereas actual earnings are relevant evidence of a building's future income earning potential, actual expenses are relevant as well. *See generally* Wolf v. District of Columbia, 597 A.2d 1303. Thus, whereas the future potential, not the current earnings themselves, must constitute the basis for valuation, future expense projections are likewise relevant. Upon consideration of the expert testimony and reports, and the record herein, the Court finds that the report of the District's expert Mitchell to be the most credible on the point of expenses. In calculating the projected expense figure, the District's expert (Mitchell) took the expense history of the subject property into consideration and noted that the expenses increased each year from 1991 to 1993. The District's expert projected increased expenses in categories including utilities and insurance for a projected expense sum of \$3,107,700. This amount represents \$9.00 per square foot of leasable area. The Court finds that \$9.00 per square foot of net rentable area is the correct expense figure for the subject property.

As discussed above, the Court finds that the Total Effective Gross Income for the subject property is \$11,364,220. The operating expenses, for net rentable area, total \$3,107,700. Thus, Court finds that the Net Income, before taxes, is \$8,256,520 for the subject property.

#### Capitalization Rate

The capitalization rate is one variable within the income capitalization equation. District of Columbia v. Rose Associates, 697 A.2d 1236 (D.C. 1997). The capitalization rate represents a percentage ratio between the annual income expected

to be generated by a building and the price a ready, willing, and informed buyer would be willing to pay for it in a given year. District of Columbia v. Rose Associates, 697 A.2d 1236-1237 n.1.

The determination of an appropriate capitalization rate for a particular year for a particular property is a fact-specific determination not susceptible to a single definition. District of Columbia v. Rose Associates, 697 A.2d at 1238-1239. So long as Department of Finance and Revenue bases its determination on a generally accepted method, its position on the appropriateness of a selected capitalization rate should be given due consideration by the trial court. Rose Associates, 697 A.2d at 1238-1239. Moreover, the District's capitalization rate methodology should not suffer any undue restrictions on otherwise generally accepted methods of valuation in contravention of the broad statutory directive that the Mayor shall take into account "any factor which might have a bearing on market value." Rose Associates at 1238; *see also* D.C. Code §47-820(a).

After deriving an economic net operating income, the District's assessor (Washington) divided her NOI of \$8,271,381 by a capitalization rate of .0997 to obtain a rounded estimated value of \$82,963,000. The District's assessor testified that she did not calculate the capitalization rate, but took the figure from a range of rates shown in a table from the Pertinent Data Book. The capitalization rate selected from the Pertinent Data Book by the District's assessor was for properties in the category of "Above Average Quality/Above Average Location/Above Average Condition/Below Average Risk."<sup>4</sup>

---

<sup>4</sup> The Court notes that the Data Book capitalization rate for "Average" quality, location, condition, and risk for Tax Year 1995 is 0.1089.

The Petitioner asserts that the District's assessor incorrectly selected the capitalization rate. The table from which the District's assessor (Washington) selected the capitalization rate included an assumption of an appreciation of 2% per year for ten years.<sup>5</sup> The Petitioner asserts that the assumption of a 2% per year appreciation had the effect of a substantial adjustment downward of the overall capitalization rate, before application of the effective tax rate.

The Court will now examine the capitalization rate utilized by the District's assessor.<sup>6</sup> The District's assessor used the Pertinent Data Book capitalization rate of 9.97%. In calculating this capitalization rate, the Data Book figures use a mortgage constant of 9.26%, a figure that mirrors the District's expert's (Mitchell) mortgage constant of 9.264%. The Data Book uses an equity yield rate of 11.5% compared to Mitchell's 6.0% equity dividend rate and Hortsman's 7.0% equity dividend rate. The Data Book chart calculates the mortgage constant and the equity yield rate, then adds the figures for a weighted average of .0983 (or 9.83%). A ten-year "equity build-up" is subtracted from the weighted average for a basic rate figure of .0899 (of 8.99%). The Court notes that the Data Book basic rate figure of 8.99% compares with the Petitioner's expert's (Horstman) selected 9% market capitalization rate. Next, an "Appreciation" figure (2% per year for 10 years) of .0117 is subtracted from the basic rate for an overall rate of .0782. Added to the basic rate is the effective tax rate of .0215 for the final Data Book overall rate of .0997 or 9.97%.

The Court finds that, in selecting the capitalization rate, the District's assessor did not assume that the property would increase in value 2% per year. The

---

<sup>5</sup> Petitioner's exhibits 8 and 14.

<sup>6</sup> Petitioner's exhibit 8.

Court notes that in her deposition, the assessor for the District (Washington) stated that there had been a decline in the number of office building sales and that there was a reduction in the sales price of some income-producing property.<sup>7</sup> The Court heard testimony from Phillip Appelbaum, a senior assessor in the District's Standards & Review Division. Mr. Appelbaum stated that the real estate market had seen a downturn and that by the valuation date, January 1994, no appreciation was expected in the immediate future.<sup>8</sup> The Court therefore finds that the assumption of an appreciation of 2% per year for ten years was arbitrary.

The Petitioner Taxpayer bears the burden of showing a defect in the methodology underlying the District's valuation. *See YWCA v. District of Columbia*, 731 A.2d 849. The Petitioner must prove a flaw in the capitalization rate used by the District's assessor. The Data Book Capitalization Rate calculations utilize the mortgage equity technique for deriving capitalization rates. The Court finds that the Petitioner fails in its burden of showing that the Data Book calculations are not based on a generally accepted method. Thus, in accordance with the District of Columbia Court of Appeal's opinion in *Rose Associates*, 697 A.2d at 1238-1239, this Court gives due consideration to the appropriateness of the District's selected capitalization rate.

This Court finds, however, that although the Petitioner has not proven a "flaw" in the capitalization rate calculation elements, including the mortgage constant and equity yield rate, the Petitioner has shown that the District's assessor *incorrectly applied* an overall capitalization rate which includes 2% appreciation

---

<sup>7</sup> Petitioner's Exhibit 23, p. 38-41.

<sup>8</sup> Petitioner's Exhibit 24, p. 13-15.

figure when it was not assumed by the District's assessor that the subject property would appreciate at that rate. The Court finds that the selection of the overall capitalization rate must be made in light of the status of the subject property. While the District "should not suffer any undue restrictions on otherwise generally accepted methods of valuation," as opined in Rose Associates, the Mayor shall take into account any factor which might have a bearing on market value in accordance with D.C. Code §47-820(a). *See also* Rose Associates at 1238. This Court finds that the potential appreciation rate, or lack thereof, of the subject property has a bearing on market value. Thus, the Court finds the application of the Data Book capitalization rate calculation, without adjustment or consideration for the actual status of the subject property, to be erroneous.

The Court notes that both the District's expert (Mitchell) and the Petitioner's expert (Hortsman) calculate capitalization rates for the subject property without a 2% appreciation rate figure. In calculating the capitalization rate of 10.65%, the District's expert (Mitchell) utilized the Band of Investment technique. This technique uses the weighted average of the returns on debt (the mortgage constant) and equity (the equity dividend rate). The District's expert applied a mortgage constant of 9.264% and an equity dividend rate of 6.0% to arrive at a rate of 8.61%, adjusted to the rate of 8.5%, a figure in the District's expert's opinion that is "appropriate for application to the subject property in this analysis."<sup>9</sup>

---

<sup>9</sup> The District's expert gives no further explanation for this opinion. The District's expert's "preliminary rate" of 8.5%, not 8.61%, was then adjusted for the tax burden. As stated in the District's expert's report, "[a]dding the 2.152% adjustment for tax burden to the unadjusted overall rate of 8.5% develops a total capitalization rate adjusted for exclusion of real estate taxes of 10.65%." The Court further notes that the District's expert considered three comparable sales with capitalization rates of 9.25%, 7.3%, and 9.5%.

The Petitioner, through its expert (Horstman), argues that the capitalization rate should be 11.15%. The Petitioner's expert utilized the Band of Investment technique, a mortgage constant of 9.6% and an equity dividend rate of 7.0%. The Petitioner's expert arrived at a 9% market capitalization rate "adjusted" to 11.15%.<sup>10</sup>

This Court finds that the market capitalization rate, prior to adjustment for taxes, is the figure that warrants further consideration. The District's expert's figure is 8.5%, the Petitioner's expert's figure is 9.0%, and the *Korpacz* figure, considered by both the District's expert and the Petitioner's expert, is 8.93%. Upon consideration of the experts' reports on record, the Court finds that a capitalization rate lower than the *Korpacz* average suggests that a property has above average income producing potential. Higher capitalization rates are commonly associated with weaker market properties. Upon consideration of the testimony and record herein, the Court finds that the subject property is not a "weaker" market property. This Court finds that the appropriate basic rate should reflect the subject property's above average income producing potential. Mr. Horstman's 11.15% capitalization rate exceeds the average capitalization rate cited in the *Korpacz* Report "free and clear" capitalization range.<sup>11</sup> Mr. Mitchell's 10.65% capitalization rate is consistent with properties, like the subject property, with stronger than average income producing potential. Thus, the Court finds that the basic capitalization rate shall be

---

<sup>10</sup> The Petitioner's expert states in his report that he considered three comparable sales with capitalization rates of 9.4%, 9.0% and 10%-9.10%. The record also shows that the Petitioner's expert noted the *Korpacz* Survey capitalization rate of 8.93%.

<sup>11</sup> Petitioner's exhibit 16, page 137.

8.5%, adjusted by the effective tax rate of 2.15, for an overall capitalization rate of 10.65%.

Value

The Superior Court may affirm, cancel, reduce, or increase the assessment. D.C. Code §47-3303. Where the Court finds that the District's assessment is flawed, the Court must determine the correct estimated market value. Brisker v. District of Columbia, 510 A.2d at 1039. The Court finds that the capitalization of income method of valuation is appropriate and undisputed in the instance case. For the purposes of Tax Year 1995, the present value of the property equals the annual income generated by the property divided by the capitalization rate. Thus, the Court finds that the income of \$8,256,520 divided by the capitalization rate of 10.65% yields a present value of \$ 77,526,009 as the correct estimated market value of the subject property.

Land Assessment

The Petitioner asserts that the land assessment was based upon flawed methodology by making "unwarranted adjustments" to the FAR rate and by failing to account for the Downtown Development District. Both parties agree that the highest and best use of the subject property is an office building. The relatively recent construction of the new office building using the maximum FAR potential of the subject land represents the highest and best use as of the January 1, 1994 date of valuation. The Court finds that the permissible FAR is 10.5 and that the subject

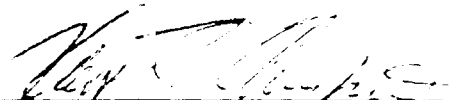
status of the subject property. **WHEREFORE**, it is on this 3<sup>rd</sup> day of January, 2000, hereby

**ORDERED**, that estimated value of the subject real property is \$77,526,009.00; and it is further

**ORDERED**, that the assessment record for the property shall be adjusted to reflect the value determined by this Order; and it is further

**ORDERED**, that the Respondent shall refund the Petitioner any excess taxes collected for Tax Year 1995 resulting from assessed value which is in excess of the value determined by this Order.

**SO ORDERED.**

  
JUDGE KAYE K. CHRISTIAN

Copies to:

Tanja H. Castro, Esq.  
Holland & Knight, LLP  
2100 Pennsylvania Ave., NW  
Suite 400  
Washington, DC 20037-3202

Gilbert Hahn, Esq.  
Amram and Hahn, P.C.  
815 Connecticut Ave., NW  
Suite 601  
Washington, DC 20006

Nancy Smith, Esq.  
Assistant Corporation counsel  
D.C. Office of Corporation Counsel  
441 4<sup>th</sup> Street, NW  
6<sup>th</sup> floor  
Washington, DC 20001



Richard M. Wilson  
Assistant Corporation Counsel, D.C.  
441 4<sup>th</sup> Street, NW  
Room 6N-93  
Washington, DC 20001