SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION



2020 K STREET, L.P.

v. Tax Docket No. 7250-96 &
7251-96

DISTRICT OF COLUMBIA

MEMORANDUM OPINION AND ORDER

These consolidated tax appeals concern the Petitioner's supplemental real property tax assessments for both the First Half and the Second Half of Tax Year 1996. One subject property is involved, an office building located at 2020 K Street, N.W. in the District of Columbia. Each period of taxation is represented in separate Petitions and case numbers. These cases were tried before this Court, and the Court has considered all of the evidence and competing contentions of the parties.

In the instant cases, the District not only contends that no refund should be granted, but argues also that the *de novo* values for each period of taxation should have been even higher than the original assessments. The District is entitled to present

evidence at trial to demonstrate that an increase in the original assessment is warranted. District of Columbia v. New York Life Insurance Co., 650 A.2d 671, 673 (D.C. 1994).

This is a situation in which the subject property was undergoing extensive renovation during the entirety of Tax Year 1996, and the progress of renovation was increasing from the First Half to the Second Half. There is no doubt that this office building was situated in a lucrative environment, insofar as it was poised to reopen as a first class building. Consequently, the Court has had to scrutinize very carefully the meaning of the renovation of an existing property that was already valuable. The facts that emerged at trial underscore the critical importance of looking at the trend of what is occurring with a commercial property, rather than focusing myopically upon isolated physical attributes or short-term issues.

Based upon the following analysis, this Court concludes that the original assessments were flawed as a threshold matter. Ultimately, the Court reaches different *de novo* results for each period of taxation herein. The Court finds that the property was somewhat overvalued by the District's assessor as to the First Half, and somewhat undervalued as to the Second Half of Tax Year 1996.

The original tax assessments and the trial demands of the parties (as to valuation) are compared to the Court's findings as follows:

First Half Tax Year 1996

Original Assessment: $47,832,695.00

Petitioner's Trial Demand: $42,200,000.00

Respondent's Trial Demand: $50,000,000.00

The Court's De Novo Findings: $46,454,154.00

Second Half Tax Year 1996

Original Assessment: $51,624,850.00

Petitioner's Trial Demand: $ 50,000,000.00

Respondent's Trial Demand: $57,000,000.00.

The Court's *De Novo* Findings: $52,262,013.00.

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**1 FINDINGS OF FACT AS TO INCORRECT ASSESSMENTS**

The subject property is owned by a partnership and is denominated as Square 787, Lot 847 in the District of Columbia. It is fundamentally an eight-story office building, erected in 1975, with three levels of underground parking.

The property has 416,638 square feet of gross building area above grade. It has 261,365 square feet of leasable office space and 26,926 square feet of leasable retail space. This property also has 1,972 square feet of storage space, and approximately 94,842 square feet of parking area. The property is zoned C-3-C (Medium Density Commercial).

The assessor who determined the tax for the First Half of 1996 was Larry Hovermale, and the date of valuation was July 1, 1995. The assessor who determined the tax for the Second Half of 1996 was Phyllis Holmes, and the date of valuation was December 31, 1995. The taxpayer called both Hovermale and Holmes as adverse witnesses in its case-in-chief. Hovermale originated the method for determining the tax. Subsequently, Holmes adopted it and did not question it. The trial evidence discloses the

following undisputed facts as to how they each performed their respective, supplemental assessments.

To make his basic annual assessment, Hovermale attempted to employ the capitalization of income approach to value. He used solely economic data to create his "stabilized" net operating income. He rejected the actual income and expense figures that had been reported to the Department of Finance and Revenue by the taxpayer. He admitted at trial that he was aware that the property was not stabilized. Nonetheless, he multiplied his figures for the economic net operating income by a capitalization rate of .11, to arrive at an "as stabilized" market value of $39,965,000.00.

Hovermale made no adjustments to this valuation, even though he admitted and conceded at trial that the property was not stabilized on the January 1, 1995 valuation date. Hovermale's performance revealed an erroneous method of determining fair market value by the traditional capitalization of income approach.

By rendering a fundamental, annual assessment for this property for Tax Year 1996, Hovermale set the stage for the supplemental assessment, because the supplemental assessment (which is the subject of this trial) was founded upon the same annual assessment – with certain arbitrary modifications.

Hovermale composed the First Half Supplemental assessment by his own, personal formula. He started with the annual assessment and merely added the raw costs of renovation that reportedly had been expended as of June 8, 1995. Such costs were $7,867,695.00. When added to the basic, annual assessment, the supplemental assessment became $47,832,694.00. There were no other calculations or adjustments and no other factors or professional judgments considered.

As to the Second Half supplemental assessment created by Phyllis Holmes, it is clear that she merely piggybacked upon what Hovermale had done.

Holmes testified that she simply added to Hovermale's supplemental assessment an additional amount for further raw costs of renovations. She did absolutely nothing else.

## CONCLUSIONS OF LAW AS TO ORIGINAL ASSESSMENTS

The applicable law regarding assessment appeals in the Superior Court requires the finder of fact to determine first whether the two supplemental assessments were flawed or incorrect.

Hovermale performed his own version of what purported to be an application of one of three recognized analytical approaches to value, *i.e.* the one known as the capitalization of income approach. All parties herein agree that the so-called "income approach" is the correct methodology to be utilized for this particular office building property.

As the District of Columbia Court of Appeals has observed, the income approach classically "entails deriving a 'stabilized annual net income' by reference to the income and expenses of the property over a period of several years. That annual net income is then divided by a capitalization rate – a number representing the percentage rate that taxpayers must recover annual to pay the mortgage, to obtain a fair return on taxpayers'

equity in the property, and to pay the mortgage." Rock Creek Plaza-Woodner Ltd. Partnership v. District of Columbia, 466 A.2d 857, 858 (D.C. 1983).[1]

Hovermale's method of assessing the subject property was flawed and erroneous for several reasons. First, he founded all of his work upon a totally unsupported presumption that the office building property was stabilized. This was literally untrue, because the building had been emptied of all tenants due to the sweeping nature of the renovation project. The building was producing no income at all during this period of taxation.

Hovermale admitted at trial that he had been well aware that the property was not stabilized. Yet, he certainly did not correctly perform the income approach to valuation because he never made any downward adjustments in order to calculate the "as is" value of the property.

Second, the particular methodology used by Hovermale was not in fact any one of the three standard approaches to value. He cobbled together his own idiosyncratic formula. No expert testimony was offered by the District to support the notion that what he did conformed to a generally accepted methodology that prevails in the appraisal industry. In his trial testimony, Hovermale's only excuse for his strange assessment was his terse statement that "the assessors always did it this way."

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[1] The Court of Appeals has ruled that determination of a capitalization rate is fact-specific in any particular assessment appeal and "not susceptible to a singular definition." *District of Columbia v. Rose Associates*, 697 A.2d 1236, 1238 (D.C. 1997). This Court quotes *Rock-Creek-Woodner* for illustrative purposes. However, for the sake of clarity, this Court notes that neither party in the instant litigation quibbled with the essential elements of what a capitalization rate should cover, as set forth in *Rock Creek-Woodner*. Instead, the parties differed with each other over the nuances and reliability of the manner in which their respective rates were calculated. Thus, the basic definition of a capitalization rate should not become a diversion from the real issues in this case.

Notably, the District's newly hired Chief Assessor (who testified separately as an expert witness for the District) did not rise to support the original assessments. He was not aboard as a District employee when these two assessments were rendered. The District's Chief Assessor, James R. Vinson, diplomatically did not directly repudiate these particular assessments. However, he did repudiate the worth and reliability of a central feature of the Department's past assessments, i.e. an annual in-house compilation known as the Pertinent Data Book.

The Pertinent Data Book purports to be an annual study that is used for deriving capitalization rates. It contains crucial information such as comparable sales data for properties all over the District of Columbia. The Book is generated by the Department of Finance and Revenue.[2]

The Pertinent Data Book is not reliable in the instant case. For example, it listed the sales price for the subject property (when the Petitioner acquired it) as $23,1275.00. Vinson learned that this figure actually represented only a "land sale." This was a major understatement of value. Vinson had to rely upon information from the District of Columbia Recorder of Deeds in order to ascertain the true and accurate price for which the Petitioner bought the subject property.

As to the general worth of the Pertinent Data Book, Vinson candidly acknowledged what he discovered after arriving as the new Chief Assessor. He testified, "I couldn't understand precisely what these numbers represented or how they were derived." He generally criticized the Pertinent Data Book stating, "This information might be used in a mass appraisal technique. Mass appraisal techniques aren't the kind of

thing that we're talking about here where we do a full blown appraisal where you can take the time to actually do things right. This – this would be more of a – in the ball park quick analyses type information."

As far as the First Half Supplemental assessment is concerned, that figure is likewise infected with the same flaws. To worsen the mistakes, Hovermale inexplicably added $5,487,930 of the so-called construction costs to the land portion of the assessment. Only $3,103,090 was attributed to the improvements portion of the overall assessment. This inherently makes no sense, even under his own bizarre system. This is because construction costs are so obviously tied solely to the improvements rather than the land.

supplemental that was done by Hovermale, it is clear that the Second Half supplemental assessment made by Holmes was totally compromised by all of the same inaccuracies and shortcomings.

It is appropriate for this Court to elucidate further why the basic model used by Hovermale is unacceptable as a legitimate and accurate assessment technique. The law is well established that a tax assessment cannot be rejected solely because it was based upon market data rather than exclusively upon the actual income and expenses of the subject property. District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 115 (D.C. 1985); see Wolf v. District of Columbia, 597 A.2d 1303, 1309 (D.C. 1991). Thus, this Court does not arbitrarily conclude that the assessments herein were flawed simply because Hovermale and Holmes failed to rely upon the actual income and expense data.

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There being several obvious errors in the original assessment and in the First Half supplemental that was done by Hovermale, it is clear that the Second Half supplemental assessment made by Holmes was totally compromised by all of the same inaccuracies and shortcomings.

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Rather, this Court finds upon the unique facts herein that such actual data was very relevant and that, in context, it was error for them to consciously refuse to consider such information.

The Court of Appeals has noted, "Actual earnings, of course, 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 legal basis for valuation." Wolf v. District of Columbia, supra.

Here, the elements of actual expenses and income and the "future potential" must be seen in light of what is happening on the property. This is especially critical because the building was taken out of service altogether because of the renovation. In mid-renovation, there was risk and expense to be associated with ownership. Such factors were highly relevant to determining the fair market value of the property, since a willing buyer would have to assume the burden of such expenses and risk while being temporarily unable to earn any revenue at all upon acquisition. A sale on the open market would have represented nothing more than the purchase of the expectation of profit. Ordinarily, the level of risk should lessen over time. Thus, the risk and expense factors could appear to be very different as the renovation was commenced, versus when it is complete.

The Court is mindful that the relevant Regulations do give some leeway to an assessor to "consider" the taxpayer's "schedule of costs" when assessing a property that is under renovation. See 9 D.C.M.R. 362.1. However, such discretion is certainly not a green light to rely exclusively on raw construction costs in determining fair market value. This is especially important where the subject property was – and still is—designed to be

an income-producing property, rather than some type of utility structure such as a private garage. Even where an office building is being renovated, the Code's explicit definition of a tax assessment never changes. The Code still requires that the assessment represent the "estimated market value," not the raw cost of erecting or modifying the property. D.C. Code §47-802(4).

For these reasons, it was completely misleading for the assessors to give no heed whatsoever to actual expenses and risk associated with the property for these two particular tax years.

Hovermale and Holmes literally decided to ignore this expense and risk information as part of their analysis, and they did so capriciously. This was a gross error in and of itself.

The issue of whether the two assessments are flawed is not a close question.

Having found that the original two assessments were flawed, the Court must proceed to fix a *de novo* value for the subject property as to each of the tax periods in question.

As to both taxation periods, the Court heard expert testimony from each party. The District called as its expert James R. Vinson. While the Court took into account the fact that the District employs him, the Court fully examined his professional background and experience and qualified him as an expert witness. This matter was the subject of extensive debate between counsel, which is addressed in more detail herein infra, as to conclusions of law.

The Petitioner called Carol Mitten as its expert. Ms. Mitten has testified previously before this Court as an expert. She was not challenged as to her qualifications.

As it customarily does, this Court liberally permitted both experts to listen to each other's testimony and to comment upon the views and conclusions of the other. They did so, and this was beneficial to the Court's role as the arbiter of de novo value.

At the outset of the trial, the Petitioner complained that Vinson should not be allowed to testify for two reasons: (1) his employment with the District and (2) his lack of a District of Columbia appraiser's license. The Court ultimately ruled that he was statutorily exempt from having to maintain a District of Columbia license. Moreover, any alleged bias in favor of the District was only a factor that could be weighed by the trier of fact in determining the weight that should be given to his testimony. This Court rendered an identical ruling in a case wherein the issue arose while the instant case was under advisement. That case is *Square 345 Associates v. District of Columbia*, Tax Docket No. 7369-97. This Court's ruling is set forth in a Memorandum Order filed on June 1, 2000. For the sake of brevity, this Court incorporates herein by reference that same decision. That decision contains detailed points and authorities that were convincing as to the District's arguments.

The facts to be found by this Court emerge from disputed testimony of the experts. They each are well qualified in the field of real estate appraisal. Neither is completely right or completely wrong as to all issues. Rather, the practical result of the trial testimony is that each expert has rendered valid points on certain issues. Yet, they each also are vulnerable on other issues. The Court endeavors herein to glean the best of what each had to offer, and to reject the weakest points in both expert opinions.

## FINDINGS and CONCLUSIONS AS TO *DE NOVO* VALUATIONS

### A. First Half Tax Year 1996:

The facts that the Court finds as to the First Half supplemental period are summarized as follows.

Each expert agreed that the most appropriate methodology for appraising this realty is the application of the capitalization of income approach. They also performed calculations via other standard approaches to value as a check on their basic conclusions. These were the "replacement cost approach" and the "comparable sales approach." They both agree that the highest and best use of this property is as an office building.

The important first step in the income approach is to determine the net operating income (NOI) and to multiply that figure by a capitalization rate. This produces the "as stabilized" value. This value then must be adjusted to account for certain factors that impose costs on getting the property to an income-producing scenario. Generally, this involves calculating the costs of lease-up, finishing, and accounting for any major impediments to the production of income. The need to make such adjustments is very fundamental. It is a part of the process that cannot be ignored or skipped. Neither expert disagreed with this basic description of how the income approach must be executed.

It is undisputed that the Petitioner is the present owner of the subject property, having purchased it for the total sum of $38,850.362 on a date in late December, 1993.

The Court notes parenthetically that both Vinson and Mitten attempted to take into account the relatively recent sale of the subject property. They had a common sense duty not to ignore the sale totally, since a recent "arm's length" sale of the subject property would be one of many factors that the District should consider in determining value. See Square 345 Assoc. Ltd. Partnership v. District of Columbia, 721 A.2d 963,

972-73 (D.C. 1998). The experts were divided, however, as to whether this sale was truly "arm's length."

Vinson contends that the purchase was an "arm's length" transaction, while Mitten insists that it was not. The issue of whether the sale was at "arm's length" is difficult to unravel conclusively. The Court is not satisfied with the level of specificity in the trial record as to the underlying saga of what produced this particular sale. [3] Even assuming *arguendo* that the sale was an "arm's length" transaction. This transaction should not be conclusive as to fair market value. This is especially true because the sale, whatever its genesis, occurred during a time when the property was vacant and when it seemed clear that expensive renovation would be necessary.

The sale is interesting and relevant to some extent, but only because it demonstrates what may have been a minimum bargain value of the property at a time when it was empty, not actually producing income – and when the risk of renovation was at its height. This translates into the Court's assumption that the property was worth at least this much to a buyer who obtained it under what may or may not have been a bargain. . However, this information as to acquisition price should not be taken to mean any more than that. The Petitioner is certainly estopped from claiming that the property was worth less than this purchase price as to either assessment date. The significance of the Petitioner's purchase price should not be given inflated importance. It does not deserve any further weight in a *de novo* analysis of valuation.

The most logical process for determining a reliable de novo valuation is for the Court to compare how each expert derived his or her own appraisal for this taxation

period, and then to consider the most important structural, conceptual, or computational problems with each one. Indeed, the Court finds certain flaws in the appraisals of both experts. Consequently, the Court must make its own choices about the significance of those issues.

First, the record reflects that the singular weakness in the valuation derived by Mr. Vinson is his failure to employ a "generally accepted" method of performing the income approach – and his unacceptable attempt to finesse his short-cut analysis.

Specifically, Vinson developed the figure of $6,309,201.00 to represent the net operating income (NOI). Ms. Mitten developed the figure of $5,842,698.00. These two expert conclusions are remarkably similar. Their land valuations are also nearly the same. Vinson valued the land portion of the property at $23,000,00.00. Ms. Mitten valued the land at $23,300,00.00. Under these circumstances, the core difference between the valuations reached pursuant to the income approach is their respective treatment of deductions that should be made in order to portray the "as is" value of the property.

After applying her capitalization rate to the NOI that she developed, Mitten derived a "stabilized" value of $54,900,000. Then, she calculated the "as is" value by making downward adjustments of $12,743,237.00. Those adjustments included: $2,757,419 for outstanding construction costs; $4,012,273 for outstanding tenant improvements; $4,162,749 for lag vacancy; $1,676,154 for leasing commissions; and $134,642 for "free rent" concessions that already had been made to two tenants.

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Mitten explained that the overall foundation for her choices of deductions included several factors that weigh upon the costs to bring the property to a stable condition as of the date of valuation. For example, she gave weight to the fact that the property was still undergoing renovation, that it was largely vacant, that only 16% of the office space had been leased, and that the commercial real estate market was still recovering from a recession.

In stark contrast, Mr. Vinson completely failed to make any deductions or adjustments to his "as stabilized" value, in order to establish an "as is" value. This was a gaping hole in his execution of the classic income approach. He attempted to rationalize this failure by relying upon a generalized explanation that ironically mirrors the central flaw in the original assessments that have been rejected by this Court.

Mr. Vinson explained, as to his "reconciliation," that his added to the approximate purchase price of $39,000,00 the sum of "$9 million or thereabouts" that he believed had been expended by the taxpayer in construction costs. He concluded, "So I knew they had about $48 million into the property. And I assumed that they weren't into this to lose money, so I assumed that the value as of July 1 [*sic*] should have been slightly above $49 million or $48 million or $49 million, somewhere about that for some entrepreneurial increment. So I concluded that $50 million was the correct number." This statement was made in his pre-trial deposition testimony. He acknowledged at trial that this was indeed his method of estimating the fair market value of the property.

To be clear, Vinson did employ the other two standard approaches to value, as a check on his income approach analysis. He did perform the calculations involved in the cost approach and the comparable sales approach – and used various adjustments in both

of those processes. Yet, the income approach was not executed in any conventional, "generally accepted" way at all. Ironically, Vinson's theory of the $9,000,000 "add-on" of costs bears an eerie resemblance to the unorthodox mode of valuation that was used by Hovermale. While articulated more smoothly in trial testimony, it amounts to the same thing.

Having found a rather fundamental and unacceptable error in Vinson's income approach, it is important for the Court also to consider certain alleged problems in Mitten's calculations and her own selection of certain adjustments.

Wherever possible, the Court endeavors to utilize an expert's appraisal as a cohesive whole. In fact, during closing arguments at trial, this is exactly what the District strongly urged the Court to do. However, in *de novo* fact finding, the Court must exercise its sound discretion and accept only what is justified in the record. The Court may utilize portions of one or more expert opinions or, the Court can simply impose its own modifications to the original assessment that is the subject of the trial. See Square 345 Assoc. Ltd. Partnership v. District of Columbia, supra, at 965-66.

In effect, this Court must reject the appraisal made by Vinson, but will adopt only certain aspects of Mitten's appraisal. Her final appraisal figure for the First Half of this Tax Year will be increased, to some extent, by the Court's own modifications. Still, the taxpayer is entitled to a refund.

In Mitten's appraisal, the most critical issues relate to the downward adjustments made as part of the income approach.

First, the District correctly points out that Mitten's adjustment for "free rent" is duplicative of consideration of this factor, which already should have been recognized in

her NOI calculations. This is because her NOI calculations appear to be based on "net effective rent," which should have included free rent concessions. The District makes a good argument, and the Court will eliminate the duplicative adjustment of $134,642.00.

Second, the District argues that Mitten's figure of $4,162,749 for "vacancy lag" was inflated in its importance and should not have been applied. The Court agrees. This is where some of the expert viewpoints of Vinson are quite compelling, despite his flawed application of the income approach.

In his trial testimony, Vinson confronted the very basic question of what the vacancy really meant to this particular property at this point in its history. He explained that the mere fact that the property was vacant was not to be taken automatically as a quantifiable drain on the overall value of the property. The massive renovation simply could not be executed properly unless the building was emptied of its tenants. The building's outside "skin" had to be removed. The building could not be safely occupied at all under such conditions. Withstanding vacancies was, in essence, a totally expectable part of obtaining an eventual higher value for the property – and higher future income.

The so-called vacancy lag here was not the product of negative economic forces. A good example of properly-deductible "lag" would be vacancies that result from lack of leasing interest in an unattractive, inconvenient, or debilitated property. The core concept is that vacancy is a drain on value and future income stream because the property is not competitive for some identifiable reason.

Outside forces can create many such reasons. For example, vacancy can be a drain on value and future income stream because of a general economic recession or overbuilding of office space in the market. These kinds of vacancy-related problems are

not controllable by the property owner. By contrast, any loss of short-term income due to temporary vacancy during both periods of taxation herein was a factor of the owner's making. Acquiring a vacant or substantially vacant building under massive renovation was a free and voluntary choice. It is an entrepreneurial choice.

As a common sense principle, the Court concludes that "vacancy lag" should not be used as an adjustment unless the vacancy problem negatively impinges upon the future income stream of the property. This cannot be said to be true where the planned future increase in the value of the property literally cannot be accomplished without sustaining vacancy for a relatively short period of time. This insight into the meaning of "vacancy lag" was a valuable contribution of the District's expert, despite the Court's rejection of his appraisal.

Estimating fair market value must reflect certain logic. A willing purchaser in the open market cannot have it both ways, *i.e.* for the purchase price to be lowered by so-called vacancy losses, while also gaining added value and future income because of the renovations made possible by the same vacancy. For these reasons, the Court as the trier of fact will eliminate "vacancy lag" from the adjustments.

For the sake of brevity, the Court will not recount all of the other points raised by the parties and the various rejoinders thereto. It suffices to say that any substantial differences between the two expert valuations that are not addressed specifically by the Court herein are those that the Court finds were satisfied in favor of the Petitioner for the same reasons argued on the record by the Petitioner's counsel. This treatment of the issues applies to the Court's discussion herein of both taxation periods.

The capitalization rate determined by Mitten was 10.85%. The capitalization rate determined by Vinson was 10.65%. The more convincing of the two is the rate of 10.85%. This is because Mitten's rate was primarily derived from several specific national rate surveys, such as Korpacz. The origins of Vinson's capitalization rate were less clear.

In applying the income approach on a de *novo* basis, the Court accepts the NOI developed by Mitten, as well as her capitalization rate, and makes adjustments thereto only in the amount of $8,445,846. The Court's reduction in the adjustments is based exclusively upon the elimination of $4,162,749 for "lag vacancy," as well as the elimination of the figure of $134,642 for "free rent."

In conclusion, applying the rate of .1085 to the NOI, and then deducting the justifiable adjustments of $8,445,846 from the stabilized value of $54,900,000, the Court finds that the *de novo* value of this property for the First Half of Tax Year 1996 was **$46,454,154**.[4] Real property taxes must be recalculated according to this conclusion. A refund is due, with interest.

B. **Second Half Tax Year 1996**:

The issues surrounding the assessment for the Second Half of Tax Year 1996 are similar to the issues that emerged as to the First Half. over how to derive a capitalization rate.

In oral argument, counsel for each party disagreed significantly on whether it is prudent for the Court to embark upon what they described as "mixing and matching"

elements from each appraisal. The District contended that the Court should accept one valuation or the other, in wholesale fashion – under the broad rubric of "consistency." The Petitioner, in contrast, argued that the Court should be accurate by using the justifiable elements of either appraisal and discarding the unsupportable parts.

On the whole, the Court finds that in order to correctly and efficiently determine the facts as to *de novo* value, it is ultimately not fair to either side to adopt the entirety of one appraisal without culling the most problematic parts thereof. As the following findings and conclusions will reflect, the Court has endeavored to give credit where credit is due, without arbitrarily accepting an appraisal that retains its own significant flaws.

Looking at the proverbial bottom line, it is fair to say that the chief difference between the final, appraised values of Vinson and Mitten is found in certain key deductions to calculate the "as is" value. In addition, in order to set forth a *de novo* value, the court must grapple with the calculation of a capitalization rate. The Court will address the deductions and the capitalization rate as separate issues, in order to express most clearly how the Court reaches its decision.

The Court has listened carefully to the testimony of both experts, including the rebuttal and surrebutal presentations that were offered as a result of their ability to scrutinize each other's testimony. In order to compare the reliability and underlying worth of each appraisal, the Court has examined the component parts of each. The Court has also compared each expert's concrete figures to that expert's corresponding philosophy about how to appraise a property in transition.

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[4] This Court adopts Mitten's valuation of the land, because of the overall accuracy of her appraisal. The facts of record do not explain the precise source of the differences between the two land values developed

The District's expert calculated that the NOI for the Second Half Tax Year was $6,304,201.00.

The Petitioner's expert calculated that the NOI for the Second Half Tax Year was $6,210,624.00. The two figures above are not remarkably different.

The capitalization rates of each expert are certainly different. As to the capitalization rate, the Court concludes that the more reliable and accurate rate is the one developed by Mitten. For the Second Half of Tax Year 1996, the District's expert applied to his NOI a capitalization rate of .1016. Mitten applied to her NOI a capitalization rate of .1086.

Mitten testified that her rate resulted from a study of sales of comparable properties, as well as surveys of investment information such as Korpacz and the Real Estate Research Corporation. In contrast the rate used by Vinson, according to him, came from his applicable of the mortgage equity technique. Yet, this was compromised by his assumption that the value of the property would compound, at a rate of at least 3.5% each year for ten years.[5] Mitten estimated that without this unproven assumption, Vinson's valuation figure would have been ten million dollars lower. This criticism is sensible. The Court accepts the capitalization rate developed by Mitten.

The remaining debate between the two experts is found in how each expert treated the whole subject of having to make downward adjustments. Mitten opined that the District's expert had not made sufficient adjustments for such items as leasing

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by the two experts.

[5] This is seen on page 61 of Vinson's appraisal report.

commissions and tenant build-out, among others. These two particular items are significant. Mitten's observation is well founded.

The Court begins its examination of the District's position by reviewing the conceptual framework that was Vinson's guide for his appraisal.[6] Vinson testified that he had visited the building and found it to be a "Class A" structure. As to relevant economic trends, he noted that the District had been plagued by a recession in 1990 and that little construction occurred. In 1995 and 1996, he said, the office building market was "at the bottom of the trough." He implied that because the market was on the way up, and because the property was well-situated, the newly-renovated building was destined to be very valuable.

The record reflects that this property had retained some of its original tenants, despite the fact that they had to vacate the building during the renovation. One major new lease had been signed in July, 1995 with A T & T, for a substantial amount of space. The rooftop penthouse had been built, a new lobby was constructed, in addition to a first level retain arcade. By this time, the building contained viable retail tenants, such as the restaurant known as Legal Seafoods.

The overarching philosophical premise of the District's expert was that this property was a virtual "diamond in the rough," and that the loss of tenant and income was not a downside to value, but was a only temporary cost of insuring greater value. While this particular philosophical premise is worthwhile and sensible, it was not matched by reliable figures to give it life.

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[6] His basic outlook applied to his appraisals for both taxation periods.

All of the above-cited facts and information as to economic trends and the state of the property should have been reflected in factual details that would support the figures in Vinson's appraisal.

His appraisal for the Second Half of Tax Year 1996, however, suffers from the following problems. First, he did not make any adjustments for tenant improvement and leasing commissions. The Court views these kinds of adjustments as rather standard. They have been used and cited by countless other experts on both sides of tax appeals in the Superior Court. This is not a new or unique concept.

The Court has examined closely Vinson's attempts to rationalize how he treated such adjustments. His assertions are not convincing or substantial. For example, he belatedly claimed that he had actually did impose a deduction for "tenant improvements," citing to his appraisal report. On page 51 of that Report, it appears that he took a deduction of $6,000,000 for "remaining cost of renovation." Nothing further is specified as to what portion of this $6,000,000 is really attributable to "tenant improvements." Accordingly, this particular contention of Vinson is not supported.

Secondly, the District's expert assumed a massive appreciation in the value of the property, by some 42% during an arbitrary holding period. Yet, as Mitten credibly pointed out, speculative building is not supportable in the marketplace during this period of time. This is a logical principle, especially where office buildings are concerned.

Third, to the extent that Vinson failed to make a deduction for leasing commissions, this was a major mistake. Vinson testified that leasing commissions are merely an "element of speculation" that should not have a number attached to it. This does not make sense, because leasing commissions are a highly predictable and easily

quantifiable cost of marketing and actually bringing tenants to the property. This is not a close question.

The appraisal of Mitten is far more accurate than that of Vinson, even though the Court must modify it based upon one solid point offered by Vinson. With this one exception, the Court is impressed that Mitten took appropriate and logical deductions to bring the property to an "as is" value. Some of what she did was controverted by Vinson, and the Court pauses to examine their competing views.

One, Vinson testified that the Petitioner's expert should not have taken a lump sum deduction for the cost of tenant build-out. The District's expert asserted that the costs for tenant build-out or finish should be amortized over time.

Mitten's emphasis was that expensive finish for A T & T was taken as a lump sum deduction, which in turn served to reduce the apparent value of the rent level specified in the lease. In an A-class building, as Vinson describes it, this is expectable where office space is concerned. Moreover, the Court cannot reasonably presume that the cost of the finish of such a large tenant should be amortized. It is directly related to servicing a very prominent tenant, and is not a discrete cost that applies literally to all of the space in the building

Two, Vinson also testified that one of the major differences in their valuations is attributable to the great differences between the calculation of "net effective rent." He contends that the accurate net effective rent was $51.00 per square foot. Mitten contended that the accurate net effective rent was $16.00 per square foot.

To justify her figures, Mitten explained that although one might look to actual leases to presume that space would lease for $51.00 per square foot, this should be offset

by the cost of tenant build-out. The Court agrees that "net" means just that, *i.e.* there is an offset from somewhere. Mitten identified the source. In other words, Vinson should not have assumed that the net effective rent could be presumed from the rent cited in the A T & T lease. Raw figures from one lease do not tell the whole story. Major tenants can demand and obtain top quality and expensive finish.

The Court cannot adopt the view that tenant build-out should be amortized, because once it is done, it is done. This is not an expense that must be repeated on a schedule or which will be done the same way on each occasion. This is why it should be treated as a lump sum item when it occurs at a time that is relevant to a valuation date. Tenant build-out costs do not necessarily diminish the value of the future income stream, as such.

As with the appraisal for the First Half of Tax Year 1996, the one troublesome aspect of Mitten's appraisal concerns the treatment of "lag vacancy." This was one of her significant deductions from the "stabilized value." Here, Vinson renders a superior opinion. The Court agrees with Vinson's expert opinion as to what "vacancy lag" really represents in the unique scenario of the instant case. In any particular assessment appeal, it is imperative for the Court to examine whether the fact that rentable space is unoccupied is truly a problem that detracts from the market value of the property. Here, it does not. The vacant office space was not undesirable or uncompetitive at all. It was merely not available for a short time. For the reasons previously set forth herein, it was not appropriate to apply a deduction for "lag vacancy" in the Second Half of Tax Year 1996 for the subject property.

In short, the Court cannot adopt Mitten's entire appraisal without reducing the deductions for calculation of an "as is" figure. Her adjustments totaled $6,345,298.

The Court will reduce the deductions by the figures cited by Mitten for "lag vacancy." This amounts to $1,379,673 for office vacancy, and $27,638 for retail vacancy. The Court otherwise adopts as reasonable and accurate the balance of Mitten's appraisal for the Second Half of Tax Year 1996.

To recapitulate: after applying Mitten's capitalization rate to the NOI that she developed, the stabilized value is $57,200,000 (rounded). The Court will apply deductions of $4,937,987, having eliminated the combined $1,407,311 deduction for "lag vacancy." Thus, the *de novo* value for the Second Half of Tax Year 1996 is $52,262,013.

Having made these findings, the Court will direct the Petitioner to file a Motion for Entry of Judgment, containing the precise figures that will reflect the refund due as to the First Half, as well as the additional tax due as to the Second Half. When these figures are reconciled, a net refund may be due to the Petitioner or a net amount of additional tax may be due and payable to the District.

WHEREFORE, it is by the Court this 6th day of July, 2000 ORDERED that the assessment for First Half Tax Year 1996 is hereby set aside. The tax for this period of taxation shall be calculated based upon the *de novo* valuation of **$46,319,512.00**; and it is

FURTHER ORDERED that the assessment for the Second Half Tax Year 1996 is hereby set aside. The tax for this period shall be recalculated and billed to the Petitioner based upon the *de novo* valuation of **$52,262,013.00**; and it is

FURTHER ORDERED that the Petitioner shall, within 30 days hereof, prepare and file with the Court a proposed order for entry of judgment after calculating the precise amount of any refund or payment that is due. Upon entry of judgment, interest shall accrue as provided by applicable law, commencing with the docketing date of the final judgment.

Cheryl M. Long
Judge

Copies mailed to:

Tanja Castro, Esq. [present counsel for Petitioner]
Holland and Knight, LL:
2100 Pennsylvania Avenue, N.W. Suite 400
Washington, D.C. 20037-3202

Gilbert Hahn, Jr., Esq. [former counsel for Petitioner]
Amram and Hahn, P.C.
815 Connecticut Avenue, N.W., Suite 601
Washington, D.C. 20006

Nancy Smith, Esq.
Assistant Corporation Counsel
441 Fourth Street, N.W. 6th Floor
Washington, D.C. 20001

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION



2020 K STREET ASSOCIATES,

v. Tax Docket Nos. 7250-96 & 7251-96

DISTRICT OF COLUMBIA

# ORDER

On September 26, 2000 the District of Columbia filed a Petition for Clarification with respect to this Court's Memorandum Opinion and Order that had been filed on July 6, 2000. The Petition is not opposed and will be addressed herein.

The gist of the Petition is to alert the Court that there is a discrepancy between the recitation of a certain important figure in two different places in the Opinion. This obviously requires clarification by the Court because the figure in question is the Court's own finding as to the assessment for the First Half of Tax Year 1996.

On page 3 of the Opinion and Order, the Court wrote that the Court's *de novo* finding of valuation is "$46,454,154.00". However, on page 26 of the Opinion and Order, the Court mandates a reduction to "$46,319,512.00". One of the figures must be corrected.

Based upon the following factors, the Court has determined that the correct figure, which should appear in both places, is $46,454,154.00. The correct figure is the Court's *de novo* valuation that was based upon the Court's modification of the valuation that was offered by the Petitioner's expert witness, Carol Mitten. As is reflected on page 14 of the Memorandum Opinion and Order, Mitten developed a stabilized value of $54,900,000.00 (rounded). The Court found no basis to reject this much of her valuation process. However, for reasons set forth in the Memorandum Opinion and Order, the Court did not credit all of the adjustments that she applied to this figure. Instead, the Court deducted from this stabilized value only the sum of $8,445,846.00. See page 19 of the Memorandum Opinion and Order. The result of this subtraction is the final figure of $46,454,154.00. As an exercise of its discretion, the Court chose not to round its final figure.

It suffices to say that the incorrect figure that appeared originally on page 3 of the Memorandum Opinion and Order was a product of the Court's first draft that was not fully corrected when the Opinion was filed. The court is responsible for the error on page 26.

WHEREFORE, it is by the Court this 4th day of January, 2001

ORDERED that the Petition for Clarification is granted; and it is

FURTHER ORDERED that the Court's Memorandum Opinion and Judgment filed on July 6, 2000 is hereby corrected and modified as follows: on page 26 thereof, on line 19, the figure of $46,454,154.00 **shall be inserted and substituted** for the figure of $46,319,512.00. This will correctly reflect that the real property tax for the First Half of Tax Year 1996 shall be recalculated based upon the *de novo* value of $46,454,154.00; and it is

FURTHER ORDERED that counsel for Petitioner shall file within 30 business days hereof a proposed order for entry of judgment after calculating the precise amount of any refund or payment that is due. Upon

entry of judgment, interest shall accrue as provided by applicable law, commencing with the docketing date of the judgment.

Cheryl M. Long
Judge

Copies mailed to:

Nancy Smith, Esq.
Assistant Corporation Counsel
441 Fourth Street, N.W. 6th Floor North
Washington, D.C. 20001

Tanja H. Castro, Esq.
Holland & Knight LLP
2100 Pennsylvania Avenue, N.W. Suite 400
Washington, D.C. 20037-3202

Claudette Fluckus [FYI]
Tax Officer

# SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
## TAX DIVISION

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| 2020 K STREET, L.P. | : | |
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| | : | |
| v. | : | Tax Docket No. 7250-96 |
| | : | & 7251-96 |
| | : | |
| DISTRICT OF COLUMBIA | : | |

## ORDER

This matter came before the Court for trial upon the petitions for a partial refund of real property taxes for the first half supplemental assessment and second half supplemental assessments for Tax Year 1996. On January 4, 2001, this Court entered an Order modifying its Opinion and Order which was entered on July 6, 2000. These orders reduced the assessment for tax year 1996 first half supplemental to a total of $46,454,154 and the second half supplemental assessment to a total of $52,212,013. It is this 2nd day of February, 2001

**ORDERED** that petitioner is entitled to a refund of real property taxes paid for the first half of tax year 1996 on Lot 847 in Square 787 of $14,819.32, with interest at the rate of six percent per year from October 15, 1996 until paid, and it is

**FURTHER ORDERED** that petitioner owes additional real property taxes for the second half of tax year 1996 on Lot 847 in Square 787 of $6,849.50, and it is

**FURTHER ORDERED** that petitioner is entitled to a total net refund of real property taxes paid for tax year 1996 on Lot 847 in Square 787 of $7,969.82, with interest at the rate of six percent per year from October 15, 1996 until paid.

JUDGE

cc:

Nancy Smith, Esq.
Office of the Corporation Counsel
Assistant Corporation Counsel, D.C.
441 Fourth Street, N.W.
Washington, D.C. 20001

Tanja H. Castro, Esq.
HOLLAND & KNIGHT LLP
2099 Pennsylvania Avenue, NW
Suite 100
Washington, D.C. 20006

Natwar Gandhi
Chief Financial Officer
Office of Tax and Revenue
941 North Capitol Street, NE
8th Floor
Washington, DC 20002

WAS1 #909228 v1

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION



2020 K STREET LIMITED PARTNERSHIP,

v.

DISTRICT OF COLUMBIA

Docket Nos. 7250-96 and 7251-96

ORDER

On July 2, 1998 this Court received in chambers copies of two pleadings that were filed with respect to a discovery dispute that has erupted close in time to the trial that is scheduled for July 16, 1998.

On June 25, 1998 the District of Columbia filed a Motion for Protective Order and to Quash Subpoena, asking the Court to prohibit counsel for Petitioner from taking the deposition of Todd Zirkle. An Opposition was filed by Petitioner on June 30, 1998.

The gist of the controversy is that the District resists the subpoena primarily because neither party listed this person as a witness in its pretrial statement. The District also states that this individual "was employed by the District of Columbia as a supervisory assessor in February 1998, and began his employment at that time. The valuation dates of the supplementary assessment at issue are July 1, 1995 and December 31, 1995. Mr. Zirkle would have no direct [] supervisory knowledge of these assessments and depositions of the actual assessor of the property are scheduled

for June 30, 1998."[1]

In defending its right to depose this individual, the taxpayer does not rely upon any listing of Zirkle as a trial witness. Rather, the Petitioner points out that the person who has been named as the District's designated expert witness (James R. Vinson) has stated only recently in his written appraisal report that Zirkle was "a participant in its preparation."[2]

Furthermore, counsel for Petitioner emphasizes that, at the time that pretrial statements were filed, the District had not yet turned over any expert appraisal report. Thus, the final identity of any experts or associated factual sources was not yet known to the Petitioner. In addition, the District's Answers to Interrogatories had not provided any hint of the involvement of Zirkle.

Counsel for Petitioner specifically states that the District had received Interrogatories asking for the identity of "all persons with personal knowledge of facts material to this case." There was never any supplemental mentioning Zirkle.

The Motion for Protective Order has no merit. This is not a close case, for several reasons.

On the subject at hand, the District of Columbia Court of Appeals has stated,

> Before a protective order may be entered . . . the party seeking it must make a showing of

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[1]Memorandum of Points and Authorities in Support of Motion for Protective Order, at page one.

[2]Opposition, at page two.

> good cause, stating with some specificity how it may be harmed by the disclosure of a particular document or piece of information. 'The burden then shifts to the party seeking discovery to establish that the disclosure is both relevant and necessary to the action. . . . To show necessity, the party seeking discovery must demonstrate that the information is necessary to the preparation of its case for trial, including proving its own theories and rebutting those of its opponent.'

Mampe v. Ayerst Labs., 548 A.2d 798, 804 (D.C. 1988)(citations omitted), quoting Plough, Inc. v. National Academy of Sciences, 530 A.2d 1152,1155-1156 (D.C. 1987).

The District has not alleged that any harm will befall to the City of the deposition goes forward.

In contrast, the Petitioner has set forth an ample basis for permitting the discovery, even though the burden technically has not shifted to the Petitioner because the District itself has not met its threshold burden. Several factors are important to note.

First, the measure of whether a deposition ordinarily may be convened is based upon the relevance of the testimony that is sought. Since the District does not deny that is designated expert partly relied on some type of contribution by Zirkle, his testimony would be relevant to understanding the genesis of the expert's opinion, and the correctness of such opinion as contrasted to the correctness of what Zirkle contributed. This is so, even if Zirkle is never called by either party as a witness. The fact that no one initially listed him as a witness in a pretrial statement is a frivolous point.

Information that is gleaned in discovery can be valuable for

purposes of preparing cross-examination, preparation of direct examination questions of other persons, or general trial strategy. These are all classic instances in which "relevant" information can be critical to any party. This issue of whether Zirkle ever testifies is not pivotal at all.

Experts are permitted to render opinions that are based in part upon hearsay. In the instant case, the taxpayer is entitled to learn and test the accuracy of the underlying hearsay or assistance that aided the expert in his ultimate conclusion. Nothing could be more obvious where the need for pretrial preparation is concerned. The need for this information is highlighted by the fact that the Petitioner carries the burden of proof at trial.

The key factor, under the circumstances, is that the involvement of Zirkle was unknown to the Petitioner at the time that pretrial statements were filed. The noting of the deposition is late in the pretrial process, but is excusable. This is a late-breaking development, occasioned specifically by the District's disclosure of its expert appraisal report.

In fairness to both parties, the Court's view is that either party should be permitted the right to call him as a witness, as an adverse witness by Petitioner or in the defense case by the District. Any disputes over the relevance of particular testimony will be adjudicated by the Court during trial, in the context of the development of the record. This witness, essentially, is (to the taxpayer) a surprise addition to the underlying story of the

fair market value of the subject property. The present situation illustrates the risk that is undertaken by all parties in a tax assessment appeal, when they chose to set a trial date without knowing that all discovery is complete as to expert witnesses. Yet, this is the common practice in this jurisdiction, seldom presenting any alleged crisis such as this.

WHEREFORE, it is by the Court this 2nd day of July, 1998

ORDERED that the Motion for Protective Order is hereby denied.

Cheryl M. Long
Judge

Copies mailed to:

Nancy Smith, Esq.
441 4th Street, N.W. Sixth Floor North
Washington, D.C. 20001

Gilbert Hahn, Esq.
Amram and Hahn
815 Connecticut Avenue, N.W. #601
Washington, D.C. 20006