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SUP FOR COURT OF THE DISTRICT OF

Tax Division

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COURT HOUSE OF THE DISTRICT OF COLUMBIA
DISTRICT OF COLUMBIA
TAX DIVISION

FILED

WISCONSIN BUILDING, INC.,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

Tax Docket Nos.

3312-83 and 3267-83

ORDER

These matters came before the Court for trial on June 21 and 25, 1984. The cases involved a property for which petitions challenging assessments for tax years 1983 and 1984 were filed. Both actions were consolidated for purposes of trial. This Court has jurisdiction to hear these appeals pursuant to D.C. Code §§47-3305 (1981), made applicable by §47-825 (1981).

BACKGROUND

The property subject to this action is a five story plus basement building and land identified as Lots 015 and 030 in Square 1778. The property is known as 4000 Albomarie Street, Northwest, and 4435 Wisconsin Avenue, Northwest.

In Tax Docket No. 3267-83, Petitioner challenges the tax year 1983 assessment of the improvements and land identified as Lots 015 and 830. This property was assessed by Respondent at \$1,562,010. Upon administrative appeal and hearing, the assessment was sustained by the Board of Equalization and Review on May 25, 1982.

In Tax Docket No. 3312-83, Petitioner challenges tax year 1984 assessment of the improvements and land identified as Lot 015 only for tax year 1984. The property was initially assessed at \$1,500,000. Upon administrative appeal and hearing, the assessment was increased by the Board of Equalization and Review to \$1,750,000 by decision dated May 27, 1983.

FINDINGS OF FACT

The Court, having considered the pleadings, testimony and documentary evidence offered at trial and argument by counsel, adopts the following findings of fact:

1. The subject property is an office building with ground floor retail use which regularly generates an income stream.

2. Petitioner's expert witness estimated the value of the subject property based on the income approach to valuation. The expert witness, F. Alden Murray, Jr., stated his opinion that the subject property is an investment property and that the value lies in what a prudent investor would be willing to pay for it. He based his estimate of value to investors on a capitalization of net income produced by the property.

3. The income approach "bases assessed value on the amount that investors would be willing to pay to receive the income that the property could be expected to yield" ^{1/}
9 D.C.M.R. §307.5 (1982).

4. Petitioner's appraiser employed a capitalization process which converts into present value anticipated future installments of net income. For a capitalization rate, Mr. Murray determined a rate of return on equity and adjusted

^{1/} These municipal regulations further state that the income approach is to be used by the assessor's office in accordance with the following guidelines:

- "(a) An indication of the value of an income producing property may be estimated by computing the present worth of a future income stream;
- (b) The income stream shall be capitalized or converted into an indicated value; and
- (c) The amount to be capitalized may be either the gross return or the net return." 9 D.C.M.R. §307.5 (1982).

it for non-liquidity and risk. Secondly, he determined a mortgage component for the value by consulting Washington, D.C. area lending institutions for interest rates, loan-to-equity ratios and length of loans. The investor's capitalization rate for Washington, D.C. thus determined was approximately 15.7 percent for 1981, the calendar period just preceding the tax year 1983 valuation date of January 1, 1982. Petitioner's expert then consulted tables published by the American Council of Life Insurance of Washington, D.C., which indicated the 1981 average capitalization rate for the Middle Atlantic region to be 15.5 percent, in the same range as the investor's capitalization rate developed from local research. He used the average rate in his calculations. Similarly, for the 1982 calendar period relevant to tax year 1984, Mr. Murray developed from local research an estimated investor's rate of 12.53 percent, then selected the Middle Atlantic regional average of 12.10 percent. As the respondent's counsel pointed out at trial, the District of Columbia actually is classified for the purposes of the above-mentioned insurance tables as part of the broader South Atlantic region.^{2/} South Atlantic regional figures were 12.8 percent for 1981 and 11.7 percent for 1982.

Mr. Murray developed projections of future net income and capitalized them at rates which differed between the two years at issue. As a result, his estimations of value did not remain static between tax years 1983 and 1984. In projecting income, he made adjustments in both years to account for the office space occupied by the property owner.

2/ "Middle Atlantic" as used by the American Council of Life Insurance refers to New York, New Jersey and Pennsylvania. "South Atlantic" is used to refer to Delaware, Maryland, the District of Columbia, Virginia, West Virginia, North Carolina, South Carolina, Georgia and Florida.

5. The appraiser concluded that for tax year 1983 the estimated fair market value of the subject property was \$913,000 and for tax year 1984 the estimated fair market value was \$1,100,00.

6. Petitioner's property manager, Mr. Joseph Donlin, testified that the income and expense data, on which Mr. Murray later testified he based his analysis, was truthful and accurate. Furthermore, he stated that in his experience such data was normal and reasonable for comparable buildings.

7. Petitioner presented testimony that the subject property, on which the building was constructed in 1956, was in relatively poor condition, lacked adequate parking in or near the building, and suffered the disruptive effects of nearby subway construction and the competition for rental income from higher quality properties. Petitioner's witnesses testified that all leases in the subject property were negotiated at arms length and with an intent to reflect the marketplace.

8. The Respondent's witness Quinton Marvell, was the assessor who was responsible for assessing the subject property for the years at issue. He testified that he relied solely on a market approach to valuation, one of the methods permitted under the District of Columbia regulations.^{3/} In employing that approach, the assessor relied on data developed from the sales prices of property he deemed comparable to the subject property.

9. The sales used by the assessor to assess the valuation of the subject property were principally from the years 1977 and 1978. The dates of valuation of the subject property are January 1, 1982 (tax year 1983) and January 1, 1983 (tax year 1984).

^{3/} See 9 D.C.M.R. 5907.2 (1982).

10. The assessor testified that he used his judgment in making adjustments from those sales he deemed to be comparable in order to arrive at the assessment for the subject property. He did not develop mathematical formulas or other calculations in determining adjustments, nor did he substantiate any basis for his adjustments. Adjustments according to judgment were made by the assessor to account for differences in zoning, building age and sizes, and age of the sales. No adjustments were made by the assessor to account for differences between the properties used as comparable and the subject property as to the following: mortgages or other financial data, the amount of available parking, the physical condition of the structures, the average net rental incomes, the number of floors or elevators, the size of land area, the nature of the tenancies (i.e., single or multi-tenanted properties), the amount and type of retail uses, or other factors. The assessor testified that he did not know whether the sales he deemed to be comparable were arms-length transactions.

11. Applicable law requires as follows:

In determining estimated market value for various kinds of real property 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 §47-020 (1981).

12. Municipal regulations state as follows:

In determining the assessed value of property the Director shall take into account all available information which may have a bearing on the market value of the real property including, but not limited to, the following:

- (a) Governmental imposed restrictions;
- (b) Sales information for similar types of real property;
- (c) Mortgage or other financial considerations;
- (d) Replacement costs, less accrued depreciation because of age, condition, and other factors;
- (e) Income earning potential (if any);
- (f) Zoning;
- (g) The highest and best use to which the property can be put; and
- (h) The present use and condition of the property and its location.

9 D.C.M.R. §307.1 (1982).

13. Applicable municipal regulations which specifically govern the comparable sales approach to valuation require "reasonably comparable properties," recent sales, sales from within the same or "similar areas," and "arm's length transactions" unless sales are "adjusted for differences".

9 D.C.M.R. §307.3 (1982).

14. The assessor testified that he charted, on a spreadsheet, sale activity of small commercial office buildings in upper Northwest Washington. On this worksheet, which was introduced into evidence, he recorded property location, date of sale, sale price, year built, gross building area, net rentable area, zoning, F.A.R., land area and the breakdown, if any, for office and retail space. Having done so, he testified that he selected a value for the subject property of \$1,500,000 or \$38.66 per gross building area and \$44.73 per net rentable area, figures within the range of sale activity.

Properties used as comparable were at the following locations, sale dates and prices:

<u>Location</u>	<u>Sale Date</u>	<u>Price</u>
2241-51 Wisconsin Avenue	7/19/84	\$1,800,000
4001 Brandywine	7/19/84	2,700,000
3216 New Mexico Avenue	6/29/78	2,021,000
1680 Wisconsin Avenue	2/22/78	825,000
4228 Wisconsin Avenue	1/4/78	3,100,000
2461 Wisconsin Avenue	12/23/77	525,000
5401 Western Avenue	9/28/77	1,200,000
5185 MacArthur Boulevard	9/12/77 8/5/77	1,851,102 1,780,000
2139 Wisconsin Avenue	7/5/77	1,680,000
3301 New Mexico Avenue	3/15/77	7,981,599
2121 Wisconsin Avenue	6/10/82	9,000,000

Mr. Harvelle testified that he arrived at the square foot price used as the basis for each assessment simply by exercising his "judgment." He was unable to recount any adjustments made to sales figures to account for differences such as location.

The sales prices of two properties which sold in 1982, and which were offered into evidence by the District of Columbia solely for tax year 1984, were considerably higher (on a per square foot of gross building area basis) than the assessment of the subject property in tax year 1984. In contrast to this specific sales data, the assessor testified that sales of properties used as comparable did not indicate any reason to increase the value assigned to improvements, from tax year 1983 to tax year 1984.

15. The valuation established by the assessor for the improvements on the subject property (\$1.5 million) did not vary between tax years 1983 and 1984.

16. Petitioner's expert witness testified that he did not believe the properties identified by the assessor were comparable. He stated that they might be usable as comparables only if much more data than that used by the assessor

were considered and adjusted by means of mathematical formulas. Such data would include financing, net income stream, condition of the property and other items. He also testified that many of the properties relied upon by the assessor were in substantially differing locations from the subject property - for instance, in Georgetown - and had considerably larger buildings, had significantly greater available parking, were situated on much larger lots, were in better condition, or were characterized by differing tenancies (single tenancy, special use, etc.). He stated that several of the sales, including the Washington Clinic and Foxhall Square Mall, were not "arms length" transactions but were distress sales or corporate or partnership transfers.

ANALYSIS AND CONCLUSIONS

The petitioner bears the burden of providing its challenge to assessments and establishing value by competent evidence. Wyner v. District of Columbia, 411 A.2d 59 (D.C. 1980), Super. Ct. Tax R. 11(d). By a preponderance of the evidence in this case, petitioner has met the burden of proving that the respondent improperly assessed the subject property using the comparable sales method, that the income approach to valuation is appropriate in this case, and that the value of the property is as developed by petitioner's expert through application of the income approach.

Examining first the government assessments, the Court finds that trial testimony demonstrated the existence of numerous deficiencies. In establishing property value by the comparable sales method,

it is not adequate for an appraiser to simply report a prior sale of the property in question; he must also analyze the sale to determine its relevancy and report the results of his analysis. If it is found that the sale occurred so much before the date of appraisal as to be meaningless, this should be stated. If it is found that the sale did not represent market value and was not an arms length transaction, that conclusion, and the reasoning behind it, should also be reported.

Of the sales used by the assessor to determine value, few were current. Six occurred in 1977, four in 1978, one in 1981 and -- relating to tax year 1984 only -- two in 1982. The assessor testified that he had not investigated whether any or all of the sales were arms length transactions. Furthermore, Mr. Harvell used sales data for properties in locations widely differing from the subject property. In short, the properties are not comparable. Yet the Court fails to see evidence of how the assessor accounted, mathematically or otherwise, for necessary adjustments such as for time of sale, non-arms length transactions, location or financing, all of which impact on comparability.

Furthermore, the assessor had no articulable basis for the price per square foot he used in valuing the subject property. He merely presented a range of sales figures, without any indication how he arrived at a base figure for the property at issue.

Nor is there any indication that the assessor adequately considered changes in market conditions from one tax year to the next. For Lot C15, for which a tax year 1984 petition has been submitted, the assessor assigned the same value in tax year 1984 as 1983.

The assessor's testimony further established that he did not examine income and expense statements for the subject property, and therefore did not even consider relying on an income analysis.

The Court concludes that petitioner has met the burden of proving the original assessments arbitrary and improper, and turns to petitioner's contentions of market value based upon the income approach. The income approach to valuation is appropriate for determining the estimated market value of the subject property. The subject property is a multi-

tenanted office building with ground floor retail uses. The property's future income stream can be estimated for purposes of capitalizing net income. The testimony and evidence at trial revealed a lack of comparable sales in the data used for assessment. The Board of Equalization and Review recognized income analysis as determinative of value, as reflected by the fact that after considering the tax year 1984 assessment, the Board of Equalization and Review made an increase upon a finding that "capitalization of net income supports adjusted" estimated market value.

Petitioner's expert computed the present worth of a future net income stream and capitalized it. Respondent contends that petitioner's expert based his income analysis on inadequate income and expense data and omitted certain steps in applying the income method, and that he employed the wrong capitalization rate.

First, with respect to income analysis data, the District argued that income and expense forms submitted by petitioner lacked information on occupancy. This was true of the calendar year 1981 form, although the 1983 form did state vacancy and credit loss as a single figure. The Court credits the testimony of petitioner's expert that he gathered necessary information and made adjustments for deficiencies in these income and expense forms.

The District's further contention that the expert omitted steps in income analysis merits attention. The government has observed that the process for income capitalization by an appraiser includes estimation of gross income, deduction of vacancy and credit loss to determine net income, and comparison of both income and expense data to comparable properties to demonstrate their reasonableness.^{2/}

^{2/} See, e.g., J.D. Eaton, Real Estate Valuation in Practice -
Eaton 133 (1982), citing American Institute of Real Estate
Appraisers, The Appraisal of Real Estate (7th ed. 1978).

The District asserts that petitioner's expert failed to estimate gross income or to review comparable properties' gross income, vacancy and credit loss, and expenses. The appraisal report and support documents submitted by Mr. Murray do contain estimates of gross income, as well as vacancy and credit loss based on actual figures reported for the subject property. However, no comparables were discussed in the report or testimony. This omission goes to the weight of the expert's testimony and his opinion of the property's value.

Actual figures for property being valued do suggest a reliable basis for projecting future income and expenses. Although the District has criticized petitioner's appraisal, it has not offered any evidence that the income and expenses used for the subject property are unreasonable.

Second, the government argues that the capitalization rates used by Mr. Murray were improper, because they represented averages for financing done by insurance companies in the Middle Atlantic region. These rates were, however, very close to rates derived from Mr. Murray's research of local financing. Furthermore, the District of Columbia is in close proximity to states classified for purposes of the tables as "Middle Atlantic" -- Pennsylvania, New Jersey and New York. The Court is not persuaded that the capitalization rates selected undermine the expert's opinion of value in this case.

The Court observes that the expert had use of actual 1982 and 1983 figures in determining value, information the assessor could not have had at the time of assessment. Petitioner argues, and the Court is persuaded, that had the government performed income analysis the resulting assessment would have been within the range of error. The District had an opportunity to use the trial in part to present alternate evidence of value under the income approach. It chose not to do so.

In light of all the facts and evidence presented, the Court is persuaded that the assessor applied the comparable sales method in an improper and arbitrary manner and the income approach was the proper valuation method in this case. With respect to the tax year 1984 assessment, which the Board revised, the Court fully recognizes the Board's expertise and acknowledges the necessity of equalization. Nonetheless, the Court concludes in this case that the expert opinion of value has sufficient basis and accurately states the market value of the subject property for tax years 1983 and 1984. The assessments therefore shall be reduced by authority of D.C. Code §47-3303 (1981), made applicable by Section 47-825 (1981).

Wherefore, it is by the Court this 14th day of September, 1984,

ORDERED that the assessment value of Lots 815 and 830 in Square 1778 for tax year 1983 be, and hereby is, reduced from \$1,562,010 to \$913,000; and it is

FURTHER ORDERED that the assessment value of Lot 815 in Square 1778 for tax year 1984 be, and hereby is, reduced from \$1,750,000 to \$1,100,000; and it is

FURTHER ORDERED that the petitioner within 10 days of the date this order is signed shall present a proposed order for refund of taxes for tax years 1983 and 1984.


JUDGE PAULINE G. BARNES

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