SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION
AUG 2 1988
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TAX DIVISION

MARSHALL B. COYNE,	:	
Petitioner,	:	Tax Docket No. 3649-85
v.	:	
DISTRICT OF COLUMBIA,	:	
Respondent.	:	

ORDER

This matter came before the Court for trial. Petitioner, the fee simple owner of property located at 1177 - 15th Street, N. W. (Lot 854 in Square 214), challenges the real property taxes assessed against it for Tax Year 1985 pursuant to D. C. Code §47-820 (1981 ed.). Respondent, the District of Columbia, valued the subject property for tax assessment purposes for Tax Year 1985 at $44,000,000 in February, 1984, consisting of $8,033,950 for the land and $36,366,050 for the improvements. Petitioner appealed to the Board of Equalization and Review, which reduced the assessment to $29,655,800, consisting of $8,033,950 for the land and $21,621,850 for the improvements. Petitioner paid the tax of $602,012.74, and timely filed this appeal.

The Court exercises jurisdiction over this appeal pursuant to D. C. Code §§ 47-825 and 47-3303 (1981 ed.). Based upon the record herein and upon the evidence adduced at trial, the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. The subject property was a 19,595 square feet lot, zoned C-4 with a permitted F.A.R. of 10. It was improved by a 14 story luxury hotel built in 1962,

containing 370 sleeping rooms, three restaurants, two lounges, 13 function rooms, and guest parking.

2. Petitioner, Marshall B. Coyne, is the owner of the subject property, The Madison Hotel, and the improvements thereon and is obligated to pay all real estate taxes assessed against the subject property and to contest the assessment of said taxes.

3. On or about March 1, 1984, Petitioner received a Notice of Assessment dated February 27, 1984, stating that the assessment on the subject property for Tax Year 1985 was $44,000,000.

4. The appeal to the Board of Equalization and Review in Appeal No. 85-576 was timely filed on April 10, 1984. Oral hearing was held before the Board of Equalization and Review and by decision dated June 1, 1984, wherein the Board informed Petitioner of its decision to reduce the assessment to $29,655,800.

5. The taxes and assessment in controversy are real estate taxes and annual assessment for Tax Year 1985 in the following amounts:

Total Assessment:	$29,655,800.00
Total Taxes:	$ 602,012.74

6. The Tax Year 1985 taxes in the amount of $602,012.74 have been paid in full. First-half Tax Year 1985 taxes in the amount of $301,006.37 were timely paid on September 14, 1984; second-half Tax Year 1985 taxes in the amount of $301,006.37 were timely paid on March 29, 1985.

7. The subject property consists of a rectangular site of 19,595 square feet of land, improved with a building built in 1963.

8. The Madison Hotel is a transient hotel consisting of 384 rooms as of the valuation date of January 1, 1984. Of the 384 rooms, 370 rooms are located on the subject property and 14 rooms are located on the adjacent lot 855. (The rooms that are located on Lot 855 were included within the assessment for Lot 856.) The site is zoned C-4, and located on 15th Street, N. W., which is 110 feet wide in the Central Business District zone; this permits buildings to a nominal above-ground density of 1,000% of the lot area and height of 130 feet (plus roof structures). The existing building conforms to the zoning both in structure and in its hotel use.

9. The highest and best use of the subject property is the current use.

10. The property is adjacent to a 10 story office building also owned by Mr. Coyne. Like the hotel, it too was leased to a corporation of which Mr. Coyne was believed to be the sole owner. The hotel corporation leases some space in the office building from Mr. Coyne as reflected on the income and expense statement filed with the Department.

11. Testimony adduced at trial indicated that the common ownership had permitted the Petitioner from time to time to transfer some of the hotel functions to the office building and some of the office functions to the hotel. Further, the testimony showed some functions, such as parking, were common to both buildings and the first, second and top floors are structurally connected. Mr. Klugel's notations on Office Building Review Form, Petitioner's Exhibit 7, indicated that even when securing financing, Mr. Coyne combined the two buildings.

12. This mixing of uses has been further complicated by the Petitioner's reporting of each property's income and

expenses. Rather than reporting each property's operating experience on the Income and Expense Forms, Mr. Coyne has reported only what he has received as lease income from the operating companies. See Respondent's Exhibit 2 (hotel) and Petitioner's Exhibit 7 (office).

13. Petitioner called Mr. Anthony Reynolds as its expert witness.

14. Mr. Reynolds valued the property at $17,800,000. He testified that while he considered the cost and sales approaches, he relied primarily on the income approach to valuation.

15. Before proceeding to apply this approach to the subject property, Mr. Reynolds (both in his oral testimony and in his written report) examined briefly the operating experiences of a number of competitive properties in the Washington area. This analysis showed a wide variation in room charges, occupancy rates and related room revenues. He observed that by comparison, The Madison charged one of the highest room rates. Only the Four Seasons charged more, but in turn suffered nearly the lowest occupancy rate during the relevant period; only the Hay-Adams comparable, then under renovation, was lower. Although he testified that The Madison's management had added expenses due to the personal nature of its guest services, he never adequately explained why its experience was so radically different from other luxury hotels that were able to command high prices, presumably provide the same or better services and at the same time achieve a higher occupancy rate.

16. Though Mr. Reynolds noted the large range of variation in the luxury hotel market, in arriving at his value he used actual income rather than developing a stabilized income from the market. He added up each item

of income and then subtracted all expenses from whatever sources. He made no attempt to match income categories with related expenses. He made no examination of the appropriateness of the expenses. He then removed non-realty items; furniture fixtures and equipment, good will and working capital which together, in his view, amount to approximately one-third of the value of the property. This resulted in a value for the total hotel of $22,400,000, which included that part of hotel enterprises physically located or impacted by the office building.

The Petitioner argues that the District is in error here. Mr. Reynolds testified clearly that, using actual income, he developed a stabilized income for the entire hotel operation and then allocated the stabilized income between hotel and office building.

17. Mr. Reynolds next devised a method for removing the income and expenses he believed to be related to that portion of the hotel that was in the office building. By his determination, there were altogether 384 sleeping rooms of which 370 were in the hotel building. Based simply on square footage, he removed 5% of the room income as attributable to the 14 rooms. The same square foot method was used in removing 50% of the restaurant income. The other income items (telephone, laundry, garage, sauna and barber) not so easily attributable to particular space were assigned as they were on the owner's books. Concluding that with these reductions, only 79.38% of the income was attributable to the hotel property, he deducted a like percentage of the expenses. This resulted in a value, once the net income was capitalized, of $17,800,000 or 79.38% of Reynolds' total hotel real property value. With respect to the other income items, Petitioner argues that nothing in

the record indicates that Mr. Reynolds "assigned the income according to the owner's books" as the Respondent claims in Paragraph 10.

18. Mr. Reynolds, in his appraisal report, concluded a value of $17,956,000 using the sales approach. To arrive at this value, he compared The Madison to a wide variety of hotel properties (most of which were not comparable), automatically removed one-third for non-realty items, then reduced the composite value by the 79.38% figure derived from the income allocation scheme. Petitioner argues that Respondent's statements here are misleading. Mr. Reynolds, as is required, studied the comparable sales approach, but gave only a relative importance to it. It is not in dispute that any sale of a hotel includes both the real estate and the business.

19. The Respondent, District of Columbia, called Stephen Rushmore, MAI, as its expert.

20. Mr. Rushmore indicated that he began his appraisal assignment by touring the property, noting the parts in both buildings.

21. Finding no negative features to the building, he noted that it was in all respects a luxury hotel which in his judgment was immediately saleable since there was a large demand for such particularly by various hotel chains seeking a Washington presence. Examining other market indicators, the area's growth, employment expansion, the Convention Center and the like, Mr. Rushmore concluded that there was considerable demand for an existing luxury hotel such as The Madison.

Petitioner differs with the Respondent who asserts that "Mr. Rushmore found no negative features to the building." Petitioner maintains that the record shows the opposite.

22. Mr. Rushmore examined other hotels competing in the same market. He then reviewed the zoning, assessment history and taxes and concluded that the highest and best use for the property was as a hotel.

23. Mr. Rushmore, having considered each of the three approaches to value, determined the income approach to be of greatest use. He rejected the cost approach noting that, while this was a good approach for new hotels, it was not appropriate for this 1960's structure since it was difficult to quantify physical obsolescence. Moreover, he maintained, a typical buyer would not put much faith in such an approach. Mr. Rushmore also rejected the market data approach. He concluded that without knowing the actual value of the non-realty items, the realty's value could not be determined with enough precision that meaningful comparisons could be made.

24. Mr. Rushmore's use of the income capitalization approach first forecasted a stabilized year. For property tax purposes, he concluded that it is best to use actual income and expense figures.

25. In examining the income and expense figures, Mr. Rushmore concluded that The Madison was not being competently run and that projecting a realistic value required some adjustments to the reported figures. Specifically, he believed that occupancy could be increased to 55%, up from 47% with an average $145 room rate. He believed that income from most revenue departments would remain relatively constant with increases only in the various concessions areas. However, he noted that with proper management, departmental expenses, especially for rooms and food, could be reduced.

26. Mr. Rushmore testified that the hotel industry had adopted a Uniform System of Accounting for Hotels. In this way, expense items were not arbitrarily assigned. Using that approach, Mr. Rushmore reconstructed the 1983 income making the necessary allowances. He then removed a management fee of 3% of gross revenue, a franchise fee of 2% of room revenues, and amounts calculated to represent return on and return of personal property. This resulted in a net income attributable to the realty. Using the American Council on Life Insurance table and adding in the tax rate, he determined a capitalization rate which, when he divided into the net income, produced a value of $28,000,000.

27. With respect to the mixed use of the two buildings, Mr. Rushmore stated that there was no way of telling whether some of the hotel expenses were attributable to the office or vice versa. Particularly, with respect to energy and repairs, he was unclear how costs were allocated between the two operations. Further, he testified that he did not differ with the square foot measurement used by Mr. Reynolds, since Mr. Reynolds' basic expense analysis was unreliable and not in conformity with the Uniform System of Accounting for Hotels. Thus, the percentage used should not be applied here. While Mr. Rushmore, in response to the Court's questioning determined several other values, assuming certain percentages of the hotel operation were in the office building, none of these changed his overall value of $28,000,000 since none of Petitioner's witnesses nor its documentary evidence established any reliable evidence of the square footage, income and expenses associated with the two-building problem. Rather, all seemed to indicate a fluctuating

division and a mix of income and expenses that made reliable separation all but impossible.

CONCLUSIONS OF LAW

Superior Court review of tax assessment is de novo, necessitating competent evidence to prove the matters at issue. Wyner v. District of Columbia, 411 A.2d 59 (D.C. App. 1980). The assessed value of property for real property taxation purposes is the "estimated market value" of the property. D.C. Code § 47-820(a) (1981 ed.); District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 112 (D.C. App. 1985). In arriving at the market value of an income producing property, the assessor or appraiser must first determine the properties' "income earning potential." Id. at 115. For a Tax Year 1985 annual assessment, at issue here, the Court must determine the "estimated market value" as of January 1, 1984. See D.C. Code, § 47-820(a) (1981 ed.).

The burden is on the Petitioner to prove that the 1985 assessment of The Madison Hotel was arbitrary, excessive or otherwise erroneous and unlawful. District of Columbia v. Burlington Apartment House Co., 375 A.2d 1052, 1057 (D.C. App. 1977). It is insufficient to simply offer an appraisal report reflecting an alternative value. To provide a basis for invalidating an assessment, Petitioner must show the assessment to have been erroneously determined and the market value maintained by the Respondent to be arbitrary and excessive. Upon review of the testimony and documentation, the Court is satisfied that the Petitioner has failed to present sufficient evidence to prove the 1985 tax assessment was arbitrary and excessive.

In valuing real property for purposes of real property assessment, the appraiser may apply one or more of the three generally recognized approaches to value: (1) the replacement cost, (2) comparable sales, and (3) income capitalization methods of valuation. One method may be more appropriate depending on the individual circumstances of the subject property. Washington Sheraton, supra at 113.

The income capitalization approach is the most favored method of valuing hotels because it is most similar to the analysis made by knowledgeable and willing buyers before they would consider purchasing such a piece of property. As the Washington Sheraton Court noted at 113-114, the approach entails deriving a "stabilized annual net income" by reference to the actual income and expense history of the property over a period of time, and dividing that net income by a capitalization rate.

The Madison Hotel is somewhat unique in that a portion of the hotel is located in the adjacent office building which is also owned by Petitioner. Mr. Reynolds, Petitioner's expert, allocated between the two buildings the income and expense he determined attributable to the hotel rooms and services. Mr. Reynolds estimated the rooms' revenue from the 370 rooms on the property to be 95% of the total. He further estimated that approximately 50% of the restaurant income (including the reception and meeting rooms) derived from those facilities located in the hotel. He next analyzed all the other income received by the hotel operations. He then took a weighted average of all the sources of income to arrive at an overall estimate of income and expenses attributable to the subject property. The percentage he allocated to the hotel portion located on the subject property was 79.38%.

Mr. Reynolds analyzed the actual income history of the subject property for the period before the January 1, 1984 valuation date. From this analysis, he projected a stabilized net operating income based in part from his knowledge of the operating history of the subject property and his judgment of what the Washington, D. C. market was for similar luxury hotel rooms.

Mr. Reynolds arrived at a stabilized net operating income, then capitalized it, to arrive at an estimated value of $17,800,000 as of January 1, 1984.

Mr. Rushmore, Respondent's expert, did not derive his estimate market value by use of the actual income. He indicated that he normally would have preferred the use of actual income and expenses in the income capitalization approach in determining market value of the hotel. Here, however, in analyzing the income and expense history of the hotel, he found the income considerably lower and the expenses considerably higher than comparable local luxury hotels. In his analysis of the income and expense history of The Madison, he concluded that the owners had mixed income and expense items of the two buildings' operations. He also concluded that the owners had included some overflow from The Dolly Madison in its income and expense numbers. In his opinion, this sort of manipulating of income and expense figures made the owner's stated income inaccurate and thus any value calculated by relying on them unreliable.

Mr. Rushmore concluded that any investor looking seriously at The Madison would determine the value of the property as if it were completely managed. At the heart of the income capitalization approach is the notion that "the market value of income-producing property reflects the

present worth of a future income stream." 16 DCRR § 108(b)(3); 9 DCMR § 307.5. Thus when an income-producing property has been operating for some time (such as The Madison), its past earnings may assist the assessor. But, as Mr. Rushmore concluded, if the level of operation was abnormal as compared with similar hotels in the market and such abnormality can be attributed to management manipulation, actual income figures must and should be rejected. See Rock Creek Plaza-Woodner Ltd. v. District of Columbia, 466 A.2d 857, 858 (D.C. App. 1983).

Respondent maintains that the assessor or any appraiser must adjust for competent management when the property's income and expense history demonstrates that it is out of line with similar hotels in the market place. Without such adjustment, the property would not be in equalization or share the proper tax burden of similar properties. Mr. Rushmore made this adjustment in his valuation; Mr. Reynolds did not. The Court is persuaded that Mr. Rushmore's valuation reflects the true estimated market value.

WHEREFORE, it is this 29th day of July, 1988,

ORDERED that the estimated market value of The Madison Hotel for Tax Year 1985 is $28,000,000 of which $8,100,000 shall be allocated to the land, and $19,900,000 shall be allocated to the improvements. The assessment record card shall be so modified in accordance with this Court's Order. It is

FURTHER ORDERED that Petitioner present a proposed order for refund, with interest, no later than August 15, 1988.

SO ORDERED.

JUDGE IRALINE G. BARNES

Copies to:

Gilbert Hahn, Jr., Esquire
James J. Gross, Esquire
Janet L. Eveland, Esquire
Amram and Hahn, P.C.
1155 Fifteenth Street, N. W., Suite 1100
Washington, D. C. 20005

Nicholas Majett, Esquire
Lawrence McClafferty, Esquire
Assistant Corporation Counsel
1133 North Capitol Street, N. E., Room 238
Washington, D. C. 20002

Harold L. Thomas, Director
Department of Finance and Revenue

R. Stanfield
8/3/88