No. 1158

S ERIOR COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

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SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

MAY 4 1978

FILED

TIBER ISLAND CORPORATION,
c/o DeFRANCEAUX REALTY GROUP, INC.,

Petitioner

v.

DISTRICT OF COLUMBIA,

Respondent

Tax Division
Docket No.
2364

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

This matter comes before the Court on petitioner's appeal from an assessment of real property taxes against it by the District of Columbia for the tax year 1976.

This case was consolidated with Carrollsburg Square Associates v. District of Columbia (Docket No. 2365), and was tried by the Court sitting without a jury. Upon consideration of the testimony, the documentary evidence, the briefs and the oral arguments of the parties, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Petitioner, Tiber Island Corporation, c/o DeFranceaux Realty Group, Inc., with its principal office at Suite 200, 1909 K Street, Washington, D.C. 20006, is legally obligated to pay all real estate taxes assessed against Lot 184 in Square 502. Petitioner is lessee of the land and owner of the improvements thereon known as Tiber Island Apartments and Townhouses, 429 N Street, S.W., situated in the District of Columbia. Record title to said land, containing 218,564 square feet, is in the District of Columbia Redevelopment Land Agency.

2. The tax in controversy is a real estate tax assessed by respondent against said apartment project and improvements thereon, in Lot 184, Square 502 for fiscal year 1976, July 1, 1975 through June 30, 1976. That tax, which is based upon a total assessed value of $7,800,000.00, is in the amount of $142,740.00. Petitioner, submitting that the proper value for real property tax purposes is $5,487,000.00, claims a refund in the amount of $42,327.90.

3. An appeal by petitioner was filed with the Board of Equalization and Review on April 15, 1975. On May 16, 1975, an oral hearing was held before the Board. The Board sustained the proposed assessment by decision dated May 28, 1975. The taxes for the fiscal year 1976 were timely paid.

4. Tiber Island is a multi-family housing project built in 1964 and located in Southwest, Washington, D.C. The project consists of four 9-stor -brick highrise apartment buildings and 21 attached 3-story brick townhouses. Additionally, there is underground parking which will accommodate 297 vehicles. Each highrise building contains a lobby area with concrete ceiling and floors which are partially carpeted. The walls are partially wood-paneled, with brick and plate glass. Each building contains two elevators to service the upper floors. The public hallways are attractively carpeted and have plaster walls and ceilings. Each floor has a small trash room.

5. The actual cost of constructing the improvements, as shown by records of the Department of Housing and Urban Development, was $8,685,690.00.

6. The unit mix is as follows:

(a) 160 efficiency units consisting of living room, dining area, kitchen, one full bath, dressing room and small foyer. There are two models with 506 square feet and 550 sequare feet respectively.

(b) 128 one-bedroom units consisting of a living room, dining area, bedroom, one full bath, and kitchen. These units contain approximately 800 square feet.

(c) 64 regular two-bedroom units consisting of a living room, alcove, dining area, two bedrooms, two full baths, dressing room, kitchen, and entrance foyer. These units each contain approximately 1,200 square feet.

(d) 16 two-bedroom duplex units consisting of a living room, dining room, kitchen, and foyer on the first floor, and two bedrooms and two full baths on the second floor. These units each contain a total of approximately 1,120 square feet.

(e) 21 two-bedroom townhouse units containing a living room with hardwood flooring, den, entrance foyer, and a half bath on first level; two bedrooms and two full baths on two upper levels, a kitchen, with Brown wall oven and counter range, dining room; half basement with Marlo oil-fired heating and air conditioning system found on two lower levels. These units each contain approximately 2,000 square feet.

7. Tiber Island is part of a major government-sponsored redevelopment program which has taken place since the early 1960's. The area, which was formerly low-income slum housing, is now characterized by a variety of land uses. The commercial area, west of the subject property and along Maine Avenue, houses some good restaurants and is convenient to shopping malls and theaters. North of the area, intense office building development has taken place. Many federal government agencies, including the Department of Housing and Urban Development, have chosen to locate here. Also, a variety of residential housing types have been developed or rehabilitated. Just east of the subject property are low-income, public-housing projects.

8. This area at the time in question was plagued with an escalating incidence of crime which had made costly security measures necessary and was partially responsible for the high rate of vacancy in the project -- as high as 9% in 1975 -- which detracted from the gross income and increased the expenses of redecorating units as they turned over. Also, the noise, inconvenience, and traffic problems caused by the Metro construction, which was taking place along M Street, S.W., helped to cause the high vacancy rate.

9. High utility costs have been another problem in the project. This is due in part to the fact that the apartments were designed at a time when energy costs were only a nominal part of the operating cost compared to today. The project was therefore not designed for maximum energy efficiency.

10. Tenants in the project were all on 30-day leases in fiscal 1976 due to the D.C. Rent Control Law and the fact that rents cannot be raised while tenants are on leases.

11. The Tiber Island Apartments are located on Lot 184 in Square 502, which is land owned by the Redevelopment Land Agency (RLA) and leased to petitioner on a 99-year lease at an annual fixed rent of $41,440.00. Petitioner has an option to purchase the ground from RLA for $690,531.00 until 1981.

12. The apartments were financed under the Federal Housing Act's Section 220 insured mortgage loan program which is for new construction of residential apartments in urban renewal areas. Under this program, the developer can obtain financing for 90% of the value of the project in a 40-year loan bearing interest at 5 1/4% per annum. The owner is required to pay in addition a mortgage insurance premium of 1/2% to insure the loan by the lender. Therefore, the effective rate of interest to the borrower of the FHA-insured mortgage loan is 5 3/4% per annum.

13. A conventional mortgage for a similar building in 1975 would have been amortized over 25 or 30 years with a much higher interest rate.

14. For the year ended December 31, 1974, the Tiber Island Apartments had a gross annual income of $1,303,135.00; total expenses of $681,522.00 (excluding ground rent, financial expenses, real estate taxes and depreciation, totalling $811,837.00); and a net income of $621,613.00. The subject property had been developed to its highest and best use as of the effective date for real property tax purposes.

15. As of January 1, 1975, the income which can be generated by the apartments was effectively regulated by the FHA and the D.C. Rent Control Law. In addition, there is a competitive economic ceiling to the rents which an individual will pay for an apartment in Southwest. This economic ceiling on rents had been reached as of January 1, 1975.

16. Tax assessors for the District of Columbia determined that, because of the governmental programs under which the subject property was developed, traditional approaches to property valuation could not be appropriately utilized in this case for the determination of the fair market value of the land and improvements. Instead Mr. Landry, assessor for the government, used three approaches to value -- the Building Residual Approach, the Cost Approach, and the Capitalization of Net Income Approach -- and correlated the results to establish a final value for the property.

17. In developing his capitalization of income approach as the primary method relied upon, Mr. Landry reasoned that, since the indebtedness is insured by an instrumentality of the federal government, the minimum value of the Section 220 project could best be found by computing the minimum net income required to insure the continued operation of the property, i.e., the net income necessary to retire the mortgage indebtedness, to pay an adequate return on the equity investment equal to 10% of the total value, and to pay the annual lease fee. He determined this annual minimum net income to be $607,994.00.

18. Mr. Landry then developed a capitalization rate to measure the value of this income stream. He started with 5 1/4% representing the annual interest rate payable on the mortgage, plus 1/2% representing the mortgage insurance premium per annum. He then added .25% to compensate for the adverse land leases encumbering the property, and 1% reflecting the equity investment in the property. Finally, he added .75% for economic obsolescence, resulting in an overall capitalization rate of 7.75%. Economic obsolescence, as explained by Mr. Landry, is a judgment factor accounting for all external factors which, in the judgment of the assessor, affect the value of the property, e.g., crime rate and controls over the property imposed by Section 220 of the Federal Housing Act.

19. The annual minimum net income of $607,994.00 capitalized at 7.75% resulted in an imputed value of $7,845,000.00 for the subject property. This figure was correlated with value estimates arrived at by other approaches to arrive at a final value estimate of $7,800,000.00.

20. The petitioner, alleging that the District's method was inappropriately theoretical, took a capitalization of net income approach to valuation. It used actual income and expense figures from the property for 1974 which showed a net income of $621,613.00.

21. Petitioner then developed a capitalization rate by assuming a 75% first mortgage for 30 years at 9 1/2% and further assuming a 25% equity requirement, also at 9 1/2%, and adding 1.83% to allow for District

of Columbia real estate taxes. This resulted in an overall capitalization rate of 11.33% which, when applied to the net income stream, resulted in a property valuation of $5,486,434.00. This figure was then rounded to $5,487,000.00.

CONCLUSIONS OF LAW

1. D.C. Code §47-641 (Supp. IV 1977), provides in part as follows:

> The assessed value for all real property shall be the estimated market value of such property as of January 1 of the year preceding the tax year, as determined by the Commissioner. In determining estimated market value for various kinds of real property the Commissioner 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. * * *

2. The determination of the taxing official as to value carries a presumption of correctness. The burden is upon the taxpayer to show that the assessed valuation is incorrect. District of Columbia v. Morris, 81 U.S. App. D.C. 356, 159 F. 2d 13 (1946); Rule 11(d), of the Superior Court Tax Division Rules.

3. Although the capitalization of net income approach employed by petitioner has received court approval (Board of Assessors of Weymouth v. Tammy Brood Co., 331 N.E. 2d 531 (Mass. 1975); Glenwood Realty Co., Inc. v. East Orange, 78 N.J. Super. 67,

187 A. 2d 602 (1963)), it failed in this case to account for a number of factors having a bearing on the market value, e.g., the value of its option to purchase the land and the value of the favorable, long-term mortgage that might be assumed by a potential purchaser. Petitioner's assumption of 1975 conventional financing as the starting point in developing its capitalization rate, ignoring actual financing on the property, resulted in an aberration and an unreasonably low value figure for the project.

The conclusion that petitioner's value figure is unreasonably low is supported by evidence that several other Section 220 properties sold in recent years for considerably more than their assessed value. Furthermore, the value figure proposed is almost $4,000,000.00 less than the original cost of constructing the project in the mid-1960's. We find it difficult to believe the property has dropped so far in value.

4. The government's approach, while theoretical, incorporates consideration of the many factors referred to in D.C. Code §47-641 and is justified in the unique situation presented with respect to this Section 220 property. The subject property is one of only 9 luxury apartment complexes operating on a profit motive in the District of Columbia which enjoy the advantage of a federally insured, long-term mortgage. As such, it is difficult to compare with either low-income FHA properties or with conventionally financed commercial properties. A unique approach to valuation is therefore warranted.

We note that Mr. Landry's final valuation, representing a correlation of three valuation methods, does not give undue emphasis to the FHA financing on the property. The existing mortgage interest rate is only a starting point for developing the overall capitalization rate which was applied to the minimum net income figure to arrive at an estimate of value. The resulting value estimate was then considered in light of other indications as to value.

5. Although we conclude, therefore, that the valuation method employed by the government is warranted here because of the uniqueness of the property, petitioner has satisfied the Court that Mr. Landry did not give sufficient weight to outside factors which adversely influenced the value of the property during the tax year in question. He allowed .75% for economic obsolescence having considered Section 220 restrictions on use of the property as the primary, and perhaps only, outside influence affecting the value of the property. In light of evidence presented by petitioner as to other outside factors which impacted on the economics of the project, specifically the crime rate in the area and the inconvenience (noise, dirt and relocation of streets with the resulting high vacancy rate) caused by Metro construction, we find that an additional .75% should have been included in the capitalization rate for so-called "temporary economic obsolescence." Within Mr. Landry's primary valuation theory this would increase the overall capitalization rate to 8.5% and

reduce the total value of the project for tax purposes to $7,152,870.00. Considering all the evidence presented, this seems a fair estimate of the property's true value for the tax year in question.

Accordingly, the assessment is reduced to $7,152,870.00 and petitioner is entitled to a refund from respondent of a proportionate amount of the tax paid.

Petitioner is to submit an appropriate order within 10 days.

MAY 3, 1978.

Fred B. Ugast
FRED B. UGAST
Judge

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