

Opinion
No. 1233

CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

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FILED

INTERNATIONAL UNION OF
OPERATING ENGINEERS,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

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NATIONAL RURAL ELECTRIC
COOPERATIVE ASSOCIATION,

Petitioner,

v.

DISTRICT OF COLUMBIA,

Respondent.

Tax Docket No. 3262-83

Tax Docket No. 3263-83

ORDER

These matters came before the Court for trial on June 25, 26, and 27, 1984, having previously been consolidated. Petitioner International Union of Operating Engineers owns the property located at 1125 17th Street, Northwest, identified as Lot 107 in Square 183. Petitioner National Rural Electric Cooperative Association owns the property located at 1800 Massachusetts Avenue, Northwest, identified as Lot 56 in Square 137. Petitioners challenge tax year 1983 assessments for these properties, both of which are improved by buildings leased for commercial uses.

The parties' chief disputes concern the appropriate method of valuation, including allocation of value between land and improvements, and the proper application of methods both by the assessor and a private appraiser to arrive at assessed value. Petitioner argues that, because the subject properties provide commercial office space, their value is best determined by means of an income stream analysis. In

petitioner's view, even if the comparable sales method were taken as the means of determining value, the District improperly employed the technique as to both properties.

The respondent contends that its assessments, relying upon the comparable sales method, indicate the properties' correct value. The government further asserts that theories and calculations underlying expert opinions of value offered by petitioner were faulty.

The Court exercises jurisdiction over these appeals by authority of D.C. Code §47-825 (1981). Based upon the testimony and evidence adduced at trial, the Court makes the following:

FINDINGS OF FACT

Tax Docket No. 3262-83

1. Respondent, the District of Columbia, valued the subject property for tax year 1983 at \$6,857,400, of which \$5,414,620 was attributed to the land and \$1,442,780 to the improvements, an increase of approximately 46 percent over the prior year's assessment of \$4,700,000. Petitioner appealed to the Board of Equalization and Review, which reduced the improvements value to \$685,800, resulting in a total assessment of \$6,050,420. Petitioner paid the tax of \$128,837.94 and timely filed this appeal.

2. The subject property is located in the area referred to as the "Central Business District," which contains the bulk of Washington's office space, accounting for approximately 80 percent or 46 million square feet of the private office space. The subject property in the northwest section of the city is about one and one-half blocks north of the K Street corridor and one block east of Connecticut Avenue.

3. The property contains 14,259 square feet of land with approximately 120 feet of frontage on 17th Street on the western side. The north and rear sides front on a public alley with the southern exposure adjacent to an improved office building. The site is located in an area zoned C-4, which allows a development density of 8.5 Floor Area Ratio (FAR), according to the Lusk Directory. The building has an actual developed density of 5.30 FAR. There are no existing mortgages on the subject property.

4. Improvements on the property consist of a seven story office building built in 1956. An addition was constructed on the seventh floor in 1977, enlarging an existing penthouse area and converting the entire floor to office space. On the first floor approximately 8,000 square feet is a large open lobby with an additional 3,000 square feet of common area or auditorium used by the owner and not suitable for other commercial tenants. The building contains 73,737 square feet of gross finished area and approximately 62,000 square feet of net rentable area. One basement level is used for parking 17 cars, storage, and a mechanical room. Sub-basement area is used as storage and mechanical rooms.

5. Petitioner presented testimony that the building has functional inadequacies, including energy inefficiency, signs of physical deterioration, and limitations on prospects for multi-tenant use due to existing elevator locations, corridors, bathrooms and overall floor size.

6. The property is approximately 70 percent owner-occupied. The fifth and sixth floors were leased to tenants at \$12.00 per square foot as of January 1, 1982, and, as of that date, testimony established that the owners planned to renegotiate the leases in May, 1982, at a rate of \$16.00 per square foot.

7. As of January 1, 1982, according to evidence submitted by petitioner's expert and his appraisal report, the commercial leasing market in the District had begun to soften.

8. For commercial office buildings, the income approach to valuation frequently is used. This approach values property from an investor's viewpoint as of the valuation date, calculating a value which would give an acceptable rate of return on and of invested capital. Under this method, the income is considered in order to develop the value of a future stream of benefits. Since property is reassessed annually, such future benefits can appropriately be included in subsequent assessments.

9. The petitioner presented credible evidence, through Mr. James Ryan, its expert, and his appraisal report regarding the property's value as of January 1, 1982. Mr. Ryan used the income approach to value the property. Relying on the income history of the property, Mr. Ryan projected the 1982 per square foot rental income for the office, storage and parking areas of the property as it would appear to a person contemplating investing in the property on the valuation date. Mr. Ryan followed accepted appraisal practice in stabilizing income and expenses so as to avoid distortions in the valuation that could occur if actual income and expenses of the subject property were atypical.

10. For purposes of the income approach, the expert used the following stabilized income figures, with market rates imputed for the owner-occupied space.^{1/}

Income

Base Rent - 62,000 s.f. at \$16.00 per s.f.	- \$ 992,000
Garage - 17 parking spaces at \$60 per no. x 12	- 12,240
	TOTAL - \$1,004,240

^{1/} Included were lobby and auditorium covering 11,000 square feet, valued at rates determined by petitioner's expert to represent market value.

yield required by a lender at the time of valuation. The equity component reflected the yield thought necessary to attract investment capital at the same time. An appropriate method for determining these two components of the capitalization rate is the band of investment method which uses typical investment and mortgage requirements available in the market on the valuation date. (See Appraisal Report p. 34)

15. Mr. Ryan arrived at a rate of .0825 which was then multiplied by .25, the equity component of the capitalization rate of .0206. (See Appraisal Report p. 34)

16. As the final element of the capitalization rate, petitioner's expert calculated the real estate tax rate. Because the purpose of the valuation is to determine the proper assessment value (and thus the correct real property tax is deemed to be unknown), taxes were not considered in the expenses of the property. Therefore the tax rate, equivalent to the tax year 1983 real estate tax rate of \$2.13 per \$100 of assessed value (.0213), was added to the capitalization rate to account for this additional item that the owner must recover. The calculation of the capitalization rate therefore used the following components:

.75 mortgage ratio x .135	
mortgage constant	= .1013
.25 equity ratio x .0825	
equity yield	= .0206
Capitalization rate by band	
of investment method	= .1219
Plus real estate tax rate	= .0213
Capitalization rate	= .1432 (or .1430)

17. Dividing the capitalization rate of .1430 into the net operating income of \$499,747 produced a determination of value in the amount of \$3,494,134. The subject property has a developed density of 5.30 FAR. Petitioner submits that a density of 8.5 FAR is permitted for the site, resulting in unused development potential of 5,197 square feet. Because

District of Columbia regulations permit the transfer of such excess density,^{2/} petitioner asserts that this represents an asset of the property to be valued. Adding an excess density value of \$1,480,000 then produces a value for the property on January 1, 1982, of \$4,974,734, which petitioner rounds off to \$5,000,000. Respondent represents that in fact, the under-utilization is greater. On a street 110 feet wide, the government observes, zoning regulations permit maximum density of 10 FAR. 11 D.C.M.R. §5301.21 (1982).

18. Mr. Ryan made no specific separate allocation of value for the land and the improvements, but testified that he would allocate approximately 30 percent of his value estimate to the land and approximately 70 percent to the improvements because such a procedure was used when he was an assessor (with the Department of Finance and Revenue) over ten years ago. The assessor for the District of Columbia testified that he knew of no policy in the District of Columbia, at the date of valuation, under which an assessor would automatically allocate approximately 30 percent of a value estimate to land and 70 percent to improvements. Normally, allocation would depend upon the specific characteristics of the property involved.

^{2/} Unused development rights may be transferred to a contiguous site with C-R zoning under certain conditions. A site approved by the Zoning Commission as a Planned Unit Development can have such rights transferred from one lot to another within the proposed development provided the lots are within the same block. Petitioner acknowledged that sale of these unused development rights is theoretical as there is no apparent, immediate market available, but asserted that a true picture of the subject property should include this aspect. For purposes of obtaining a conservative valuation of this unused development, the assessor's land valuation of \$93.00 per square foot of gross finished area was used, with the result discounted by 25% to account for the limitations on transfer rights.

19. Petitioner's expert testified that, in order to verify the value derived through the income approach, he compared assessments of the subject property and properties he deemed comparable. The subject was assessed at approximately \$93.00 per square foot of gross finished area. Petitioner's expert identified five properties viewed as comparable to the subject property. Based on the assessment record cards, he calculated the assessment per square foot of gross finished area of those properties. These assessments ranged from \$48.22 to \$64.60 per gross finished square foot. The subject's assessed value was estimated to be at the upper end of the range or \$65.00 per square foot of gross finished area, indicating an equalization value of \$4,792,905, which compares favorably with the \$5,000,000 value developed through the income approach. The current assessment on the subject property of approximately \$93.00 per square foot of gross finished area therefore far exceeds the assessment levied on other commercial properties in the vicinity.

20. The respondent offered evidence, through the testimony of the responsible assessor, Paul E. Spruill, in support of the initial \$6,857,400 assessment.^{2/} On direct examination and at his disposition, Mr. Spruill stated that his opinion of value was based solely on the direct sales comparison approach to valuation. The District generally uses the income approach to value commercial office buildings for assessment purposes. The assessor admitted that he did not use the income approach to calculation in assessing the subject property for tax year 1983. It was undisputed that

^{2/} The Board of Equalization and Review set an assessment figure of \$6,050,420.

the owner of the subject property submitted income and expense forms, used to assess property through the income approach, to the District of Columbia for 1980 and 1981. This information was available to the assessor to use in determining an assessment through the income approach to valuation. Yet the assessor did not use this information.

21. The subject property, zoned C-4 consists of 14,294 square feet. For the C-4 zoned land sales used by the assessor as comparables, the price per square foot ranged from \$209.65 to \$530.61. The price per point of FAR range for the C-4 zoned land sales was \$24.17 to \$58.82. The assessor then determined that the land should be assessed at \$38.00 per point of FAR and that the assessed value per square foot should be \$380.00. Mr. Spruill testified that he used his judgment, based upon factors such as location and size, after comparing the land sales to determine where within that range of land sales the subject property should be placed. Mr. Spruill did not state any substantive basis for the figure he chose; he simply set a figure within the range of sales values. On cross-examination at trial, Mr. Spruill conceded that he made no adjustments for any dissimilar aspects of comparable property such as location.

22. The assessor testified that he examined only those documents admitted into evidence as the basis for his assessment. Those documents, however, contained no income analysis, which the assessor claimed to have performed as a check to the sales approach.

23. The assessor testified that he made the chart of C-4 land sales in late 1981 or early 1982. In his deposition, he stated that the chart was made prior to January 1, 1982.

19. Petitioner's expert testified that, in order to verify the value derived through the income approach, he compared assessments of the subject property and properties he deemed comparable. The subject was assessed at approximately \$93.00 per square foot of gross finished area. Petitioner's expert identified five properties viewed as comparable to the subject property. Based on the assessment record cards, he calculated the assessment per square foot of gross finished area of those properties. These assessments ranged from \$48.22 to \$64.60 per gross finished square foot. The subject's assessed value was estimated to be at the upper end of the range or \$65.00 per square foot of gross finished area, indicating an equalization value of \$4,792,905, which compares favorably with the \$5,000,000 value developed through the income approach. The current assessment on the subject property of approximately \$93.00 per square foot of gross finished area therefore far exceeds the assessment levied on other commercial properties in the vicinity.

20. The respondent offered evidence, through the testimony of the responsible assessor, Paul E. Spruill, in support of the initial \$6,857,400 assessment.^{2/} On direct examination and at his disposition, Mr. Spruill stated that his opinion of value was based solely on the direct sales comparison approach to valuation. The District generally uses the income approach to value commercial office buildings for assessment purposes. The assessor admitted that he did not use the income approach to calculation in assessing the subject property for tax year 1983. It was undisputed that

^{2/} The Board of Equalization and Review set an assessment figure of \$6,050,420.

However, the property referred to on line 1 of the chart was sold in February, 1982, and the properties referred to on lines 9 and 14 were sold in January, 1982. Mr. Spruill's statement that the chart was made prior to January 1, 1982, is therefore inconsistent with the inclusion of properties sold subsequent to that date.

24. Respondent introduced into evidence maps of properties indicating their lot and square numbers, some of which were referred to in Respondent's Exhibit 2. New lot numbers were entered on these maps on an ongoing basis as the lot numbers changed through property sales or other means. Mr. Spruill testified that certain of these maps and the handwritten notations on them were generated after January 1, 1984, for purposes of litigation and that he did not use them in his valuation. Petitioner brought out that numbers on a number of the map exhibits identified as being generated after January 1, 1984, correspond with those used on the chart Mr. Spruill said he completed prior to January 1, 1982.^{4/} Petitioner points to these discrepancies as discrediting the assessor's testimony.

4/ Petitioner identified the lot numbers in the 1984 maps which correlate to those in Respondent's chart as follows:

<u>Respondent's Exhibit</u>	<u>Square/Lot Number</u>	<u>Line of Chart (Exhibit 2)</u>
3C	184/71	3
4D	216/806	4
5C	127/50	5
6B	140/876	6
7C	222/24	8
8C	222/24	0
10C	252/01	11
12C	205/47	13
13C	218/79	15
14C	215/13	16

Mr. Spruill testified that he did not use the properties on lines 1, 2, 9, or 14 of the chart in arriving at his assessment.

Tax Docket No. 3263-83

1. Respondent, the District of Columbia, valued the subject property for tax year 1983 at \$16,600,000, of which \$7,699,310 was attributed to the land and \$8,900,690 to the improvements. The tax year 1982 assessment was also \$16.6 million, but the allocation was different: \$3,777,020 attributed to land and \$12,822,980 to improvements. Petitioner appealed to the Board of Equalization and Review (BER), which reduced the assessment on the property to \$15,769,310. Petitioner paid the tax of \$335,886.30 and timely filed this appeal.

2. The subject property, at 1800 Massachusetts Avenue, Northwest, is on the intersection of Connecticut and Massachusetts Avenues in the area referred to as the "Central Business District" which, as previously stated, comprises the bulk of Washington, D.C., office space. The specific area is Dupont Circle, consisting of small shops, offices and residences. Petitioner's expert observed in his appraisal report that the Dupont Citizens' Association has sought to limit development in the Dupont Circle area and large buildings like the subject property do not conform to the Association's objectives. Mr. Ryan predicted that extra management attention is therefore required to maintain the current uses and structure of the property.

3. The subject property contains 29,049 square feet of land with primary frontage of approximately 180 feet along Massachusetts Avenue, and secondary frontage of approximately 120 feet on Connecticut Avenue. The site is split-zoned between SP-2 zone and C-3-C zone, which allows a development density of 2.5 and 6.5 Floor Area Ratio (FAR), respectively. There are 16,662 square feet of SP-2 land and 12,397 square

feet of C-3-C land. The building has an actual development density of 5.95 FAR. The SP-2 (Special Purpose zone) restricts office tenancy to professionals, including doctors, lawyers, associations and unions, precluding commercial tenants and retail use, which, by restricting use, diminishes the value of the space. The C-3-C zone is less restrictive and permits commercial tenants and retail uses.

4. The subject property is improved with an eight story office building, built in 1979. The subject improvements are in generally good condition, but there is water leakage, excessive condensation on windows, and no ceiling lighting in owner-occupied space. The cost of deferred maintenance for curing these items is estimated at \$45,000. Both parties agree that the current use of the property is its highest and best use.

5. The building contains 219,710 gross square feet, including 191,967 square feet of gross finished area, and approximately 185,462 square feet of net rentable area. Approximately 173,952 square feet of the net rentable area is office space, and the remaining 9,220 square feet of net rentable area is retail space. The building has two and one-half levels of below-surface parking for 165 cars and 2,290 net storage square feet.

6. The building on the property is currently 100 percent leased with 58 percent of the building occupied by 19 tenants, 12 of which are office tenants and 7 of which occupy retail space in the C-3-C zoned area; the balance of the rentable area is owner-occupied. Most leases were signed in 1978 and 1979, and include pass through clauses for increases in operating expenses. Only about 20 percent of the leases of the total building will expire before 1990. No leases

expired in 1982. There are no provisions for Consumer Price Index (CPI), increases in the lease payment. Therefore, the owner does not enjoy a strong prospect of receiving market rental rates until the leases expire.

7. The property is encumbered with a 35 year loan of approximately \$15,823,410, which commenced June 21, 1976, and represents 100 percent financing through the National Rural Utilities Cooperative Finance Corporation, which is affiliated with petitioner. The lender acquired 5 percent equity interest; thus, the financing exceeded 100 percent of value. The interest rate on the loan is 8.75 percent through 1985, at which time it will be adjusted. Because the loan is not assumable by a third party, petitioner contends that it has no impact on value and is irrelevant to a new purchaser, who would have to obtain new financing at existing market rates. The government, on the other hand, contends that the failure to take account of the financing commitment is a flaw in the petitioner's appraisal.

8. Through expert testimony and an appraisal by Mr. Ryan, the petitioner urged the application of the income approach and demonstrated the value achieved through its use. Relying on the income history of the property, as detailed in the table in the following paragraph, Mr. Ryan projected the 1982 per square foot rental income for the office, retail, storage, and parking areas of the property, as it would appear to a person contemplating investing in the subject property on the valuation date. Rent on the subject property was stabilized at \$12.75 per square foot for tenant-occupied office space, \$13.00 for owner-occupied office space, \$22.00 for retail space, and \$13.00 for SP-zoned space, which is consistent with the average rent for the building. These

rates were considered by the expert to be lower than market rates as of the valuation date because an investor purchasing the property on January 1, 1982, would be bound by pre-existing leases. Mr. Ryan followed accepted appraisal practice in stabilizing income and expenses so as to avoid distortions in the valuations that would occur if actual income and expenses of the subject property were atypical.

9. For purposes of true income approach, the appraiser developed the following stabilized income figures for the subject property:

		<u>Income</u>	
Office (C-3-C zone)	95,725 s.f. @ \$12.75		
	per s.f.		\$1,220,494
Office (SP-2 zone)	25,790 s.f. @ \$13.00		
	per s.f.		335,270
Office (owner)	52,437 s.f. @ \$13.00		
	per s.f.		681,681
Retail	9,220 s.f. @ \$22.00		
	per s.f.		202,840
Storage	2,290 s.f. @ \$ 9.25		
	per s.f.		21,183
Garage	165 parking spaces		
	@ \$60.00 per month		118,800
Tenant Reimbursement ^{5/}			<u>350,000</u>
	<u>TOTAL</u>		<u>\$2,930,268</u>

Id. at 49.

10. A vacancy rate of 4 percent was considered typical and was applied to the subject property in consideration that a new investor would anticipate vacancies or delinquencies. Potential gross income was reduced by the vacancy rate, including delinquent and uncollectible rent as well as unleased space, in order to determine effective gross income. The vacancy rate includes a reduction for delinquent and uncollectible rent, as well as losses due to unleased space. The reduction for vacancy was \$117,211, resulting in effective gross income of \$2,813,057.

^{5/} These are amounts due to the owner resulting from the pass through of increased costs.

11. Based on the expense history of the subject property and a comparison of the 1981 expenses of the subject property with those of similar commercial office buildings, the following are the stabilized expense figures for determining the value of the subject property on January 1, 1982:

<u>Expenses</u>	
Salaries	\$129,800
Management @ 3%	84,390
Utilities	300,400
Cleaning	144,700
Maintenance	74,200
Insurance	24,100
Supplies	14,000
Security	46,400
Leasing @ 2%	56,260
Miscellaneous	22,300
<u>TOTAL</u>	<u>897,350</u>

The net operating income used by the appraiser to determine the tax year 1983 value of the subject property was \$1,915,707, the amount derived by subtracting stabilized expenses from stabilized income (\$2,813,057 - \$897,350).

12. Applying the same techniques as were used in Tax Docket No. 3262-83, Mr. Ryan determined a mortgage component of .10125 as an element of the capitalization rate. He further calculated an equity component of .01625, and then factored in the real property tax that an owner would look to recover. The resulting calculation of the capitalization rate was as follows:

.75 mortgage ratio x .135 mortgage constant	= .10125
.25 equity ratio x .065 equity yield	= .01625
Capitalization rate by band of investment	= .1175
Plus real estate tax rate	= .0213
Capitalization rate	= .1388

Dividing the capitalization rate of .1388 into the net operating income of \$1,915,707 produced a determination of value of \$13,801,924, which was rounded off to \$13,800,000. Deferred maintenance costs of \$45,000 were then deducted, resulting in an appraisal of value for the property on January 1, 1982, of \$13,755,000.

13. Petitioner's expert sought to verify the value derived through the income approach by comparing the assessment of the subject property to the assessments of comparable properties under the equalization approach. He gave his opinion that attributing 30 percent of the property's value to the land and 70 percent to the improvements would be reasonable and consistent with government assessments. In this case, the resulting allocation would be \$4,126,500 for land and \$9,628,500 for the improvements. The subject property is assessed at \$82.15 per square foot of gross finished area. Petitioner then identified four properties considered comparable to the subject property. Based on assessment record cards, petitioner calculated the assessment per square foot of gross finished area of those properties, which ranged from \$64.18 to \$78.78 per gross finished square foot.

14. Adjusting for factors such as location, physical condition, age, and zoning, Mr. Ryan estimated a reasonable value for the subject based upon comparable properties of approximately \$72.00 per gross finished square foot. This indicates a value of approximately \$13,800,000, which is close to the \$13,755,000 value arrived at through the income approach. The current assessment on the subject property of \$82.15 per square foot of gross finished area therefore substantially exceeds the assessment levied on comparable properties.

15. The respondent offered evidence, through the testimony of the assessor, Paul E. Spruill, in support of the initial \$16,600,000 assessment.^{6/} Mr. Spruill admitted at

^{6/} The Board of Equalization and Review reduced the assessment to \$15,789,310.

his deposition that he had never inspected the interior of the building for purposes of the 1983 assessment, with the exception of the first floor.

16. The comparison sales used by the assessor concerned properties singly zoned either C-3-C or SP-2. The assessor testified that he analyzed land sales of C-3-C and SP-2 sites in order to extract a unit of comparison for the subject property and to determine the land assessment. He looked at price per square foot and price per point of FAR of land which he determined to be comparable. The price per square foot for the C-3-C zoned land sales ranged from \$105.07 to \$415.00, the price per point of FAR from \$16.17 to \$63.85. The price per square foot range for the SP-2 zoned land was \$102.25 to \$140.00, and the price per point of FAR ranged from \$29.41 to \$40.00. The price per square foot for the SP-1 zoned land was \$73.33, and the price per point of FAR was \$29.33.

17. According to the government's evidence, the assessor considered the C-3-C portion of the subject property more valuable than the comparables because of its location. He assigned a value of \$456.42 per square foot to that portion. He then set a value of \$122.50 per square foot for the SP-2 portion, a figure within the range of the comparables considered.

18. The assessor testified that he developed a composite square foot price for the property. For the portion zoned C-3-C, he multiplied estimated price by the square footage. Following the same procedure for the portion zoned SP-2, he then added the two sums and divided by two. The square foot price thus derived was applied to the entire property. The property is not, however, evenly divided. The C-3-C portion of the subject property consists of 12,397 square feet. The SP-2 portion of the subject property consists of 16,657 square feet.

19. The testimony revealed inconsistencies in the assessor's representation about the procedure he employed. On direct examination, Mr. Spruill testified that his opinion of value was based primarily on the direct sales comparison approach, and that he checked his valuation through the income approach. In answer to Petitioner's Interrogatories, which Mr. Spruill signed, he had described the sales approach used and indicated that capitalization of income approach was inapplicable to his valuation.

The owner of the subject property submitted income and expense forms for 1980 and 1981, which were available to the assessor in order to apply the income approach. At his deposition, in assessing the property for tax year 1983, however, the assessor stated that he did not recall using this information.

20. On cross-examination, Mr. Spruill stated that the only documents relied upon by him in his assessment were respondent's exhibits, zoning maps, and base books. He subsequently claimed, later in the trial, that he reviewed 300 to 400 income and expense reports from other office buildings in Neighborhood 10, none of which have been identified or documented by respondent. He conceded in his deposition that the subject owner's income and expense figures appeared "competitive" and "typical."

21. The record cards for the subject property indicate that in performing the tax year 1983 assessment, respondent simply increased the assessment of the land only. The only evidence offered by respondent to support this increase were two lists of vacant land sales, one for C-3-C and one for SP-2 properties. On cross-examination, Mr. Spruill conceded that they did not consider any sales of improved properties in his valuation. The assessor testified that he did not make any

adjustments to the C-3-C land sale prices reflected in assessment documents, although he admitted that the direct sales comparison approach contemplates adjustments will be made for such factors as location and size.

22. Mr. Spruill stated that he did not take into account sales of less than 10,000 square feet because they were too small to be comparable to the subject property there (14,259 square feet). However, he included three properties with less than 10,000 square feet for comparison with the subject property, although the subject property has a land area of 29,049 square feet, greater than the 1125 17th Street, Northwest property.

23. When the values contained in the two lists of vacant land sales purportedly relied on by Mr. Spruill were compared to his assessment of the subject property, it became unclear as to how he arrived at assessed value. A list of land sales zoned SP-2 introduced into evidence by respondent contained values ranging from \$73.33 - \$140.00 per square foot. Mr. Spruill testified that he valued the SP-2 portion of the subject property at \$122.50, within this range.

24. When the square foot value attributed to SP-2 land by Mr. Spruill (\$122.50) is multiplied by the total SP-2 land area in the subject property (16,662), the result is \$2,041,095. Subtracting \$2,041,095 from the assessor's total land assessment (\$7,699,310) results in \$5,658,215, which should represent the remaining C-3-C land's value. However, dividing the C-3-C land value by the C-3-C land area (or 12,397) results in \$456.42, which according to Mr. Spruill's figures, logically would represent the value per square foot of C-3-C land. However, the highest value per square foot contained in assessment data is \$415.00, and he himself

attributes only \$265.00 per square foot to the subject C-3-C land.^{7/}

25. Mr. Spruill was unable to explain how he valued the subject improvements other than to state that he deducted the land value from the total \$16.6 million figure, but he could not explain how he determined the \$16.6 million total figure. (See Deposition at 82-87.) At his deposition, he claimed that the actual 1981 income and expense figures reported by the owner were competitive and typical and thus suited for use in the income approach, and that if the income approach were used, it would support his 1983 valuation of \$16.6 million. He testified at trial that he used a capitalisation rate of 12.5%. When petitioner's expert demonstrated the income approach using Mr. Spruill's own figures, the Court observed that these figures produced a valuation of \$12,807,336, which is even lower than the valuation proposed by petitioner.^{8/}

^{7/} The computations described were performed by Mr. Spruill on cross-examination as follows:

Land Assessment	\$7,699,310
Less SP-2 land (16,662 x 122.50)	-2,041,025
C-3-C land value	\$5,650,215
divided by C-3-C land area	12,397 = \$456.42

^{8/} Mr. Ryan performed the following computations:
Income

(Office) 175,000 s.f. @ \$12.29 per s.f.	\$2,150,750
(Retail) 10,700 s.f. @ \$18.86 per s.f.	201,802
Parking 63,650 s.f.	80,200
Escalation	171,150
Gross Income	<u>\$2,603,902</u>
Vacancy Rate @ 5%	-130,125
Effective Gross Income	<u>\$2,473,777</u>
Expenses (4.7 x 185,700)	-872,700
Net Income	<u>\$1,600,917</u>
1,600,917 + .125 =	<u>\$12,807,336</u>

ANALYSIS AND CONCLUSIONS

Superior Court review of a tax assessment is do novo, necessitating competent evidence to prove the matters at issue. Wyner v. District of Columbia, 411 A.2d 59 (D.C. App. 1980).

The respondent correctly states that the correct assessment of the subject properties for tax year 1983 is the present market value, as demonstrated under the income approach by the present value of anticipated benefits associated with the ownership of the property, as of January 1, 1982, excluding any speculative estimate of prospective value. See e.g., Washington Sheraton v. District of Columbia, Tax Docket No. 3123-83 (Sup. Ct. Tax Div. April 29, 1983), at 15.

Petitioner contends that the original assessment was arbitrary and excessive, the product of an inappropriate valuation method, improperly applied. Respondent contends that the existence of sales data was a sufficient basis for valuing the properties under the comparable sales and that the assessor methodically applied sales comparison to determine values for the subject properties. Each party further seeks to demonstrate flaws in the other's evidence of value.

The Court is convinced that the petitioner presented credible expert opinions of value for the subject properties based on the income approach. The income approach is appropriate for income-producing properties such as the subject properties, for which the typical investor likely would be willing to pay an amount in relation to anticipated returns. In American Institute of Real Estate Appraisers, The Appraisal of Real Estate (8th ed. 1983), it is stated:

In the Market, the current value of a property is . . . based on what market participants perceive to be the future income flows produced by real property.

The Court observes that respondent is correct in its view that future, not present, benefits are gauged by income capitalization. Although petitioner's appraisal report discusses reliance on present benefits, the expert's application of income analysis comports with standard practice.

Petitioner's appraiser estimated stabilized income and expenses, relying upon the history of the properties. He then developed and applied capitalization rates calculated to represent an investor's return. He took account of characteristics unique to the subject properties, as well as general market conditions existing on the valuation date.

Respondent makes several points in attempting to rebut the petitioner's affirmative evidence of value. First, the respondent questions the expert's allocation between land and improvements. The appraiser allocated value premised on a view that an estimated 70 to 30 percent, respectively, represented an appropriate ratio. Respondent presented testimony that the District did not have a practice of making such an allocation, arguing that this aspect of the appraisal was arbitrary and unorthodox. In reviewing the previous year assessment for Tax Docket No. 3263 -- upon which an estimate of value might credibly be founded -- the Court has determined that a ratio existed of approximately 23 percent land and 77 percent improvements for tax year 1982. These figures indicate that the use of a 30 - 70 division was not so arbitrary as to undermine petitioner's appraisal in that case.

With respect to the subject property in Tax Docket No. 3262, however, the tax year 1982 assessment reflected a ratio opposite the one used by petitioner's expert. Approximately 70 percent of value, was allocated to land, while about 30 percent was assigned for improvements value. Previous final assessments similarly assign a far greater portion of value to land. Petitioner did not present adequate evidence to substantiate its allocation of value. The Court is persuaded by a pattern of final assessments assigning the bulk of value to land for this particular property. The Court therefore concludes that a 70 - 30 ratio is more appropriate for land-improvements value in this instance.

Second, the government states that if a property's "excess density" may properly be calculated as an asset, the figure used by petitioner's expert should have been higher in Tax Docket No. 3262.^{9/} At the outset, the Court notes that it finds nothing inherently wrong with measuring unused density as affecting value, and the government has cited no authority to establish that such a consideration is precluded. Indeed, the principle of valuation according to a property's "highest and best use" supports inclusion of this factor.

Petitioner has not directly rebutted respondent's contention that the unused, potential density is greater than that factored in by their expert -- with the result of raising the subject property's value. Neither has respondent proposed an alternative figure for this element. Comparing the 8.5 FAR maximum to the 10 FAR maximum, the expert measured underutilization of 3.2 as opposed to 4.7. Taking

^{9/} Petitioner calculated unused development potential of 5,197 square feet, based on developed density at 5.3 FAR with a maximum density of 8.5 FAR. He estimated the transfer value of unused density at \$1,480,000.

the estimate of excess density value as 68 percent of the actual value, the add-on to income capitalization could be raised to \$2,176,470. The value calculation thus would be revised as follows:

Capitalized Income	\$3,494,734
Excess Density Value	<u>2,176,470</u>
Estimated Market Value	\$5,671,204

The revised value estimate is 13 percent higher than the estimate established by petitioner. The Court therefore determines that the figure advanced by the expert must be revised upward for an accurate estimate of market value.^{10/}

Third, respondent questions the validity of the petitioner's value because of references to market conditions such as an oversupply of office space. The government argues that the Court is persuaded that this consideration is both permissible and important, and need not involve either hindsight or quantification of impact on the subject property. Petitioner's expert merely set the stage for weighing specific evidence produced by applying the valuation methods.

Fourth, the government asserts that the financial data used by petitioner as a foundation for the capitalization rate was too broadly based, and therefore inadequate. Respondent contends that the appraisals did not reflect sufficient research on local financing. This contention goes to the weight of the evidence presented by the expert, which

^{10/} The final value need not be as high as shown in the above calculation, however, it should be recalled that application of the equalization method resulted in a lower estimate of approximately \$4,000,000. The petitioner has urged reliance on the income approach. As is noted in The Appraisal of Real Estate, supra, the valuation methods are "inter-related." Consequently,

[all three approaches [to value] are applicable to the solution of many appraisal problems. However . . . one or more approaches may have greater significance.

is essentially sound. Even if the rates considered were inclusive of other regions, the four quarters of 1981 reflect a range sufficient to indicate a basis for estimating local financing conditions.

With respect to Tax Docket No. 3263, the respondent argues that the existing financing on the property should have been considered as indicative of value. Petitioner responds that the loan is not assumable, requiring any new investor to obtain independent financing, and therefore does not affect value. Although such financing may in many cases influence value to the investor, the respondent has submitted no evidence or authority on the record to require that an unassumable loan be taken into account when assessing the value of such property.

The testimony revealed major flaws in the government's assessment of the subject properties. In both cases, the assessor failed to use the income approach, which is the prevalent method for valuing income-producing properties and the usual method in the District of Columbia to assess commercial office buildings.

In each case the assessor, in employing a compatible sales approach, had no explanation for the square foot prices he actually selected to calculate the assessments. They were simply figures somewhere near the range established by sales. The assessor relied upon vacant land sales. Notwithstanding this fact, he made no adjustments for differences between the subject properties and the sale properties. The Court fails to see how vacant land can be considered comparable in this case to properties containing seven and eight story commercial office buildings of relatively recent construction, and highly occupied.

Furthermore, an excessive amount of discrepancies arose to diminish the weight of the assessor's testimony. There were contradictions concerning when sales information was compiled, whether sales beyond the valuation date were considered, and whether any use was made of income and expense data, e.g., to apply the income approach as a check to the sales method. The Court determines that the assessor did not make use of the income approach. Even if the assessor had utilized income analysis as a check, he applied it improperly in calculations made on the stand that failed to support his assessments.

In addition to these matters, the assessor proceeded improperly to value the split-zoned property which is the subject of Tax Docket No. 3263. By establishing a composite square foot price, as if the property were evenly divided between zoning classifications, Mr. Spruill acted arbitrarily and improperly.

Petitioner has established that the assessor did not comply with the regulations, did not assess the subject properties on the same basis as comparable properties, and did not follow any generally accepted method of valuation in preparing the 1983 assessment. The assessment is therefore arbitrary, excessive, and invalid.

The Court finds that respondent presented little credible evidence to support its allegation of value or to refute the testimony of petitioner's expert. The statutory presumption of validity normally accorded an assessment has been overcome by petitioner's introduction of ample countervailing evidence. Futland Country Club, Inc. v. City of Futland, 436 A.2d 730 (Vt. 1981); Jeffer v. Town of Chester, 417 A.2d

937 (Vt. 1980); Karqman v. Jacobs, 411 A.2d 1326 (R.I. 1980). As a result, the burden of producing evidence has shifted back to the respondent, which respondent has failed to meet.

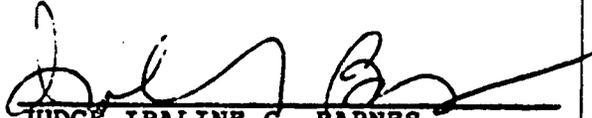
The Court determines that petitioner established by a preponderance of evidence that the values of the subject properties were \$5,000,000 (Tax Docket No. 3262) and \$13,755,000 (Tax Docket No. 3263) as of January 1, 1982. The assessment shall be reduced accordingly.

Although these cases challenge the tax year 1983 assessments only, a trial court's determination of value of taxable property remains binding on the District for subsequent tax years until genuine reassessment of property has taken place. Washington Sheraton, at 17. Accordingly, the determination that the estimated market values are \$5,000,000 in Tax Docket No. 3262 and \$13,755,000 in Tax Docket No. 3263 provide the basis for taxation for tax year 1983 and all subsequent years until lawful reassessments have been made. District of Columbia v. Burlington Apartment House Company, 375 A.2d 1052 (D.C. 1977).

Wherefore, it is by the Court this 16th day of January, 1985,

ORDERED that the respondent shall modify the assessment record cards of the subject properties to reflect the tax year 1983 values of \$5,000,000 in Tax Docket 3262 and \$13,755,000 in Tax Docket 3263 for all subsequent years until a genuine reassessment has been performed and shall promptly refund to petitioner the excess taxes which have been unlawfully collected for tax year 1983 and subsequent tax years; and it is

FURTHER ORDERED that petitioners, within 20 days of the date this Order is signed, shall present an order for refund of taxes for tax year 1983.


JUDGE IRALINE G. BARNES

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