CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

JUN 6 1 35 PM '85

Opinion No. 1238

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

FILED

13TH & L STREET ASSOCIATES, Petitioner,	:	Tax Docket Nos. 3299-83 and 3421-84
v.	:	
DISTRICT OF COLUMBIA, Respondent.	:	

FINDINGS OF FACT
AND CONCLUSIONS OF LAW

These matters came before the Court for trial on March 13, 14, and 15, 1985. In each case petitioner 13th & L Street Associates challenges the value assessed for its newly constructed office building at 1220 L Street, N.W. on Lot 42 in Square 284. This Court has jurisdiction to hear this matter pursuant to D.C. Code §§47-025, 47-029, and 47-3303 (1981 ed.). Based upon the arguments of counsel and the record herein the Court makes the following:

FINDINGS OF FACT

1. Petitioner, 13th & L Street Associates, with its principal office at 1220 19th Street, N.W., Washington, D.C., is legally obligated to pay all real estate taxes assessed against Lot 42 in Square 284. Petitioner is owner of the land and improvements thereon known as 1220 L Street, N.W., situated in the District of Columbia.

2. The tax in controversy is a real estate tax assessed against said Lot 42, Square 284, and improvements thereon for Tax Year 1983 and Tax Year 1984. The tax in controversy for Tax Year 1983 (July 1, 1982, through June 30, 1983) based upon a total assessed value of $17,307,835, is in the amount of $368,656.89. The tax in controversy for Tax Year 1984, (July 1, 1983, though June 30, 1984) based upon a total assessed value of $27,533,100, is in the amount of $586,455.03.

3. An appeal by petitioner for Tax Year 1983 was filed with the Board of Equalization and Review, on or about September 29, 1982. The Board reduced the proposed assessment from $18,307,885 to $17,307,835. The taxes for both halves of Tax Year 1983 were paid timely.

4. An appeal by petitioner for Tax Year 1984 was filed with the Board of Equalization and Review on or about April 12, 1983. The Board sustained the proposed assessment by its decision dated June 1, 1983. The taxes for both halves of Tax Year 1984 were paid timely.

5. 1220 L Street is improved with a twelve-story office building built in 1981-82, and located on 27,435 square feet of land on the southeast corner of 13th & L Streets, N.W., in Washington, D.C. Two gas stations and an apartment house are located on the other corners. The building also contains a three level basement. The gross floor area of the entire building is 376,017 square feet. The net rentable area, according to the Washington Board of Realtors' measurements, is 269,649 square feet. The developed floor area ratio (FAR) is 9.8. The building contains 165 interior parking spaces and four exterior parking spaces. The building has six high-speed elevators that serve the office floors, while a separate elevator provides service from the lobby to the parking levels. The zoning is C-4 which will allow a maximum developed FAR of ten since 13th Street is 110 feet wide.

6. The base building was completed in October, 1982, and as of January 1, 1983, the building was still a concrete shell with no tenant work having been installed. It is typical in the marketplace that tenant improvements are not installed in the premises until such time as a landlord has entered into a written lease with a proposed tenant.

7. Petitioner submitted the threshold question of whether the building was "erected or roofed" on or prior to July 1, 1982, pursuant to D.C. Code §47-829 (1981 ed.). This question bears only on Tax Docket No. 3299-83 (TY 1983). Petitioner submitted evidence that this did not occur until July 10, 1982. This evidence came in the form of a letter from Gates Engineering Company, Inc., indicating that the date of completion was July 10, 1982, the date from which the warranty for the roof would commence.

Mr. Paul Spruill, the assessor responsible for the subject property, testified that the policy of the Department of Finance and Revenue ("DFR") is that a building is not deemed to be "erected or roofed" until such time as it is completely sealed from the outside elements. On cross-examination, Mr. Spruill admitted that he did not make an interior or on-the-roof inspection of the building immediately prior to July 1, 1982. He then claimed to have conducted his roof inspection from the outside, at street level, in June of 1982. He was satisfied from his inspection that the building was sealed from the elements. He did not, however, record his inspection on the Processing Form for Commercial Permits, which is the usual Department practice.

8. The subject property is located in a neighborhood in which, until 1979-80, only three new office buildings had been erected in the last twenty years. The property is located on the northern-most border of the C-4 district, and significantly, east of 15th Street ("East End").

9. The subject land was purchased in December, 1980, for $270 per square foot. This was at a time when the real estate market was in a euphoric state and real estate developers in the Washington, D.C., area believed that any building

contructed would quickly lease up. Also in December of 1980, the petitioner obtained a non-assumable construction loan and permanent loan take-out commitment from First National Bank of Chicago. The construction loan was for a total amount of $32,000,000 at a rate of one and one-half percent over prime; however, all amounts drawn over $26,000,000 were to be personally guaranteed by the individual partners of petitioner. The individual partners of petitioner were also required to personally guarantee the completion of the improvements being constructed on the subject land.

10. After the land was purchased, the developers began working on their architectural plans and specifications, and construction on the project started in July, 1981. In August, 1981, the construction loan commenced funding pursuant to the commitment of December, 1980.

11. In the fall of 1981 petitioner contracted with Barnes, Morris & Pardoe to become the exclusive leasing agent of the building. Barnes, Morris & Pardoe immediately began to market the project. The marketing efforts included the preparation of a brochure by petitioner, as well as direct calls and mailings by the leasing agent. Barnes, Morris & Pardoe contacted every prospective tenant located in the central business district, including Georgetown, in order to see if any would be interested in relocating to 1220 L Street, N.W. These marketing activities were largely unsuccessful. A lot of traffic was generated through the subject property, but the general consensus of prospective tenants was that the location of the building was the least desirable in the East End. Prospective tenants felt that any alternative location was better.

12. According to evidence presented by petitioner and the testimony of Mr. Robert L. Klugel on cross-examination,

he real estate m ket in the District of Colum took a evere turn for the worse during the period of construction f this building. There was an over-supply of new office uildings, which coincided with a decrease in demand for ffice space. Furthermore, a national recession affected ashington, D.C., for the first time. As of January 1, 1983, here were in excess of 3.3 million square feet of office pace un-let in the East End. In response to this market eversal, developers were forced to make major concessions to enants in order to lease their buidings. These concessions ook the form of up-front rental abatements, as well as bove-standard building improvements provided to tenants at andlord's sole cost.

13. In the late fall of 1982 and early part of 1983, etitioner commenced negotiations with American Petroleum nstitute ("API") in regard to the leasing of space in the ubject property. These negotiations finally resulted in the xecution of a lease agreement between petitioner and API in pril, 1983, whereby 113,700 sq. ft. of office space and ,500 sq. ft. of storage space were leased to API for a term f twenty-five years with two five-year options. The base ffice rent for the first five years was at $20.25 per sq. t.; for the second five years, $25.25 per sq. ft.; for the hird five years, $20.25 per sq. ft.; for the fourth five ears at $30.25 per sq. ft.; and for the final five years, 32.25 per sq. ft. Because of the poor leasing climate, etitioner was required to provide the space rent-free to API or an extended period. The rental abatement of $2,200,000, quivalent to 11.35 months free rent, was all granted up ront. Petitioner, at its sole and substantial cost, was lso required to provide above-building standard tenant improvements to API. This was the first lease signed and

represented the leasing of 46.9% of total space in the building. Other space in the building leased up very slowly.

14. In the fourth quarter of 1983, petitioner applied to Perpetual American Bank, NSB, for non-assumable permanent financing in the amount of $33,000,000. In order to obtain this loan, petitioner was required to enter into a master lease for the remainder of the building which, in essence, required the individual general partners to personally guarantee the payment of the debt service on this loan. Mr. William Harps was a non-voting member of the loan committee at Perpetual American Bank, NSB, which approved this loan. Mr. Harps testified that the basis upon which this loan was approved was not the value of the project but the creditworthiness of the individual partners of petitioner who were personally guaranteeing the loan.

Because of the change in market conditions during the construction of the project, petitioner's expert concluded that the realistic rate that the subject building could be rented for was effectively $15 per square foot (after consideration of tenant allowances) instead of the originally projected $23 per square foot figure. Moreover, the anticipated rent up period after building completion was extended from one year to several.

15. As of January 1, 1983, no tenant improvements had been installed in the property. The cost to complete the tenant improvements was estimated in the range of $4.5 to $5 million and the cost of paying out leasing commissions to brokers to negotiate leases was approximately $1 - $1.5 million. These numbers indicate a total cost to complete in the range of $5.5 - $6.5 million.

II. ANALYSIS AND CONCLUSION

A. Introduction

This Court has consistently recognized that there is no statutory or common law mandate that respondent follow any one particular approach in valuing real property in this jurisdiction. D.C. Code §47-820 (1981 ed.) provides:

> 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 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.

(Emphasis supplied.) The burden of proof is on the petitioner to provide evidence sufficient to prove that assessments are arbitrary, excessive or otherwise erroneous and unlawful. Superior Court Tax Rule 11(d). See, e.g., Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. 1980); District of Columbia v. Burlington Apartment House Co., 375 A.2d 1052, 1057 (D.C. 1977) (en banc). It is not sufficient that the taxpayer present an alternative measure of value. To provide a basis for invalidating an assessment, petitioner must show the assessed value to have been erroneously determined. Respondent, in evaluating this new construction, used the cost approach which it derived from recognized cost guides. Petitioner, on the other hand, attempted to show that respondent should have utilized the income approach. The Court concludes that to the extent petitioner relied on the income approach to valuation, it was unsuccessful at trial in challenging respondent's approach or the value derived therefrom.

For Tax Year 1984, petitioner's income approach produced three different values for the same value date, and none of those values amounted to more than one-half the cost of construction. While this method produced only one value for Tax Year 1983, it suffered from the same impediments. In that year it would appear that petitioner's principal argument was that the respondent lacked authority to assess supplementally the subject property.

3. "Under Roof"

Notwithstanding his failure to record his inspection, the Court credits the testimony of Mr. Spruill that as of July 1, 1982, the building was sealed from the elements and therefore "under roof" within the meaning of D.C. Code §47-829 (1981 ed.). The Court does this with hesitancy, realizing that the better inspection would appear to be an on-the-roof inspection and recognizing the apparent inconsistency between Mr. Spruill's inspection sheet and his testimony. However, Mr. Spruill also testified that a new form of inspection was being utilized by the Department with which he was unfamiliar and which would explain his omission of the inspection date. In addition the time between Mr. Spruill's inspection, which he testified took place June 22, 1982, and the delivery of the warranty for the roof, two weeks later, was very short. The Court further notes the delivery of a warranty ten days after the cutoff date of July 1st, does not in and of itself negate a determination that the building was under roof and sealed from the elements. The two are quite distinct.

Moreover, petitioner's reliance on District of Columbia Redevelopment Land Agency v. District of Columbia, 107 Wash.L. Rptr. 949 (D.C. Super. Ct. Tax Docket Nos. 2460, 2461, 2462, and 2517, April 27, 1979) is misplaced. In that case, the building was completed and under roof as early as 1973 but

the tax year at issue was 1975. Certificates of Occupancy were issued at various times in 1973.

> Absent further regulations being promulgated by the City Council the Court holds that the condition of "erected" or "roofed and under roof" is satisfied when the Certificate of Occupancy for the entire structure is issued. In this case that was in 1973.

107 Wash.L.Rptr. at 953. Obviously, essential to the Court's holding there was the fact that the building was complete <u>two years prior to the value date</u>. Nowhere does the Court say that the building couldn't be "under roof" within the meaning of the statute <u>before</u> the Certificate of Occupancy was issued since that was not an issue in the case. The peculiar facts of that case are in no way analogous to the facts at issue here.

C. <u>Reliable Approach to Valuation</u>

This Court finds that for a new building the cost of construction, as opposed to the income approach, is, the better approach to ascertain the true value. <u>See</u>, <u>e.g.</u>, <u>Washington Sheraton v. District of Columbia</u>, Tax Docket No. 3123-82 (D.C. Super. Ct., April 29, 1983) (on appeal on an issue not relevant here); <u>Blakely v. Board of Assessors of Boston</u>, 391 Mass. 473, 462 N.E.2d 278 (1984); <u>Joseph E. Seagram & Sons, Inc. v. Tax Commission</u>, 18 A.D. 109, 238 N.Y.S. 2d 228 (1963) (Breitel, J. concurring), <u>aff'd</u> 14 N.Y. 2d 314, 251 N.Y.S. 2d 460, 200 N.E. 2d 447 (1964). In <u>Washington Sheraton</u>, this Court found:

> The "construction cost" method of estimating value is the proper method of assessment to use when commercial property is brand new and thus has not yet attained a stream of income sufficient to indicate value for taxation purposes. The construction cost approach is used to determine what a willing buyer would pay a willing seller for a new structure. This approach generally outlines the replacement cost of the building (the land is valued separately) to indicate what a buyer would have to pay to construct a similar building.

Washington Sheraton at 6. However, on the facts of this case the Court determines the cost approach alone is not sufficient. When economic and functional obsolescence is factored into the cost equation then the figures derived represent fair and reliable assessments. Such an approach as utilized in the most recent valuation by petitioner's expert appraiser, Mr. William Harps, allows current market conditions to be taken into account which may not have existed at the commencement of the project, while at the same time avoiding the speculative nature of the income approach.*/ San Medical Building Land Co. v. Department of Revenue, 283 Or. 69, 79-80, n. 11, 582 P.2d 416, 421-22, n. 11 (1978).

Thus, while the Court finds respondent's use of the cost approach more reliable than petitioner's use of the income approach to valuing the subject property, the Court also concludes that economic and functional obsolescence are factors that must be calculated into the assessment equation. Therefore, for purposes of assessing the property in question, the Court adopts the report of petitioner's expert appraiser, Mr. William Harps, which considers such significant factors.

D. Petitioner's Methods of Valuation

Mr. Harps testified on behalf of petitioner as an expert appraiser. He relied primarily on the income approach to value. He projected a stream of income and expenses for 1983-1985 and stated that in his opinion the net income would probably stabilize on or about January 1, 1985 (Mr. Harps stated in his report that the building could be completely rented up by July 1, 1985; however, for mathematical reasons,

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*/ The Court has attached hereto for reference a copy of Mr. Harps' report which calculates economic and functional obsolescence into the cost approach to valuation of the subject property.

he used the date of January 1, 1985, as the complete rent up date which adjustment made only negligible difference in the final estimate). In determining his economic rent, Mr. Harps relied on the API lease, which was under negotiation on or about January 1, 1983, as well as leases he was familiar with in the marketplace as of that same time. Further, Mr. Harps testified that it was predictable in the market and by the assessor that petitioner, as of January 1, 1983, would have entered into leases similar to the terms and conditions contained in the API lease. Mr. Harps' projections indicated a loss for 1983, and positive income for 1984 and 1985 as follows:

	1983	1984	1985
Income	$170,133	$2,358,818	$4,005,487
Pass thrus	None	+ 48,416	+ 108,932
Total	$170,133	$2,407,234	$4,014,219
Expenses	-728,052	-1,019,273	-1,337,796
Net Operating Income	-$557,919	$1,387,961	$3,576,423

Mr. Harps further was of the opinion that the property would not show positive cash flow, after debt service, until 1988 or 1989.

Mr. Harps employed a capitalization rate of 13.5% and a discount rate of 15%. In order to determine the value of the property as of January 1, 1983, Mr. Harps took the 1985 stabilized net income, capitalized it at a rate of 13.5%, and discounted this figure at 15% per annum back to January 1, 1983, to arrive at a present value. To this reversion number the discounted cash flows for 1983 and 1984 were added. This number indicated a total value of the subject property as if completed. Since the subject property was not completed, the cost to complete, exclusive of interest, was subtracted out. The subtraction of the cost-to-complete figure indicated a

total value of the subject property as it existed on January 1, 1983, of $14,600,000.

The calculations employed by Mr. Harps to reach his conclusion of value are set forth below:

1985 income of $3,576,423 capitalized at .1350 = $26,492,022

	Income		Discount Factor		Present Value
1983 Income	$ -557,919	x	.87	=	$ -485,390
1984 Income	$ 1,387,961	x	.756	=	$ 1,049,299
Reversion	$26,492,022	x	.756	=	$20,027,969
Value of building as if completed				=	$20,591,878
Less net cost to complete				=	$ 5,967,620
Value as of January 1, 1983 (rounded)					$14,600,000

Mr. Harps further testified that if, in fact, the subject building was deemed to be sealed from the elements as of July 1, 1982, that the value of the subject property including land and improvements as of that date would have been as follows:

1985 income of $3,576,423 capitalized at .135 = $26,492,022

	Income		Discount Factor (6 more months)		Present Value
1983 Income	$ -557,919	x	.011	=	$ -452,472
1984 Income	$ 1,387,961	x	.705	=	$ 978,513
Reversion	$26,492,022	x	.705	=	$18,678,876
Value of building as if completed				=	$19,204,917
Less net cost to complete					8,246,595
Value as of July 1, 1982 (rounded)					$10,960,000

Mr. Harps considered the various components of the subject property's capitalization rate, including mortgage interest rates, return on equity, and the real estate tax rate in arriving at a final capitalization rate of 13.5%. A discount rate was arrived at by considering the sum of the overall capitalization rate without the real estate tax component and the annual increase in income compounded for the building which indicates a final discount rate of 14%.

Mr. Harps testified that when there is a rental abatement as an inducement to sign a tenant to a lease, and the abatement is at the commencement of the lease, it is proper procedure to expense that loss of rental in the year in question.

Mr. Harps stated that he had prepared an earlier appraisal of the subject property as of January 1, 1983, in the spring of 1983 and that this appraisal, presented at the Board of Equalization and Review hearing, indicated a market value for the subject property as of January 1, 1983, of $18,500,000. Mr. Harps explained that in the earlier report he had forgotten to deduct the costs to complete the building and that if he had deducted such costs, his corresponding value would have been lower than the $14.6 million which he testified to in this court proceeding.

Mr. Harps offered testimony that in a normal market both the cost and income approaches should arrive at similar value estimates. However, in cases where the market changes after the commencement of the construction of the property, the income approach will likely yield a different number than the cost approach. In times of a decrease in market leasing activity and an increase of office supply as occurred here, the cost approach will indicate a higher value than the income approach; this is particularly true if economic and/or functional obsolescence is not factored into the cost approach. Mr. Harps testified that the difficulty with applying a straight cost approach without adjustment is that in a "down" market, the appraiser will ignore economic and functional obsolescence, which can be prevalent even in a new building. In giving an example of economic obsolescence, Mr. Harps used the case of two identical office buildings standing side-by-side, one which was 70% leased and the other

vacant. In that situation, even though both buildings cost the same, the building with 100% vacancy may suffer from economic obsolescence. He found that a significant amount of economic obslescence existed in the subject property because the location had not gained the hoped-for tenant market acceptance. He found some functional obsolescence as well, because the property had been overbuilt and overdesigned in a largely futile attempt to attract tenants to this fringe location. Mr. Harps testified that in using the cost approach as a check of his income approach, he arrived at a value for the subject property, as of January 1, 1983, of approximately $16,000,000.

3. Respondent's Cost Approach to Valuation

Mr. Paul E. Spruill, the DFR assessor, testified on behalf of the District of Columbia and indicated that he relied upon the cost approach to value for both Tax Year 1983 and Tax Year 1984. Under this approach, Mr. Spruill first determined the value of the land based on recent land sales in the area. The value he placed on the land portion of the assessment for both tax years 1983 and 1984 was at a rate of $260 per square foot for a total land assessment of $7,133,100. Mr. Spruill then determined the value of the improvements by relying upon a cost computation sheet which was prepared based on the gross square footage of the subject building, finished and unfinished, as indexed by Marshall and Swift. This cost approach did not make any adjustment for economic or functional obsolescence. His opinion of value as of January 1, 1983, was also based on the erroneous assumption that all tenant work in the building had been installed as of that date, when in fact none had been. The Court finds that Mr. Spruill's cost calculations, by including elements that did not exist on the property and by excluding any

consideration of economic or functional obsolescence, overstated the property's value. His opinion that as of July 1, 1982, and January 1, 1983, the total assessed value of the subject property was $18,807,885 and $27,533,100, respectively, is not supported by the evidence.

On cross-examination, Mr. Spruill testified that he had also used an income approach as an exercise in determining the fair market value of the subject property as of January 1, 1983. Under this income analysis, Mr. Spruill incorrectly assumed a 95% occupancy, and that the subject property was operating competitively with other buildings in downtown Washington. This analysis did not take into account that rent abatements and other tenant allowances would have to be given to any prospective tenant by petitioner. Furthermore, there was no adjustment to his income approach to indicate that the building was incomplete and that additional monies would have to be spent on tenant improvements to complete the interior for tenant occupancy.

Mr. Spruill also utilized a low 8% capitalization rate in his income approach, which he testified as a "riskless" rate in comparison to an interest rate one could have received on a savings account. Mr. Spruill testified that he determined this capitalization rate based on sales of occupied office buildings in the central business district west of 15th Street. These sales prices, however, according to Mr. Spruill indicated capitalization rates anywhere between 3.5% and 14%. He did not compare the sales to the subject property and did not indicate the reasoning behind his choice of 8%. The Court finds that given the adverse economic climate and the property's fringe location, a capitalization rate of 8% is plainly unrealistic.

The testimony of Mr. Joseph Morey, the draftsman who prepared the cost computation sheets, revealed an equalization problem regarding the subject property. Mr. Morey testified that he was familiar with a number of new buildings under construction in the same time period as the subject property, including the Daon Building located at 1300 New York Avenue, which he deemed to be far superior to the subject property in construction. On cross-examination, it was shown that the cost computation sheets prepared by DFR reflected that a higher cost per square foot was placed on the subject property ($72.85 per square foot) than on the Daon Building ($66.29 per square foot). This anomaly was never sufficiently explained.

Mr. Robert L. Klugel testified as to the standards of DFR in determining the assessed value for newly constructed buildings. During calendar years 1982 and 1983 DFR did not have any written manual in regard to assessment practices. However, there were some general memoranda distributed among the assessors. Mr. Klugel stated that the cost approach is the approach that all assessors must use in determining the market value for new construction. Mr. Klugel indicated that during calendar years 1982 and 1983, DFR was aware of the over-development of office buildings in the area of the city known as the East End. He stated that during this same period DFR knew that building owners were being required to give considerable rent abatements and other tenant concessions to prospective tenants. During 1982 and 1983 Mr. Klugel recognized that there was a possibility that these market conditions could have affected the value of East End office buildings in a negative manner. Mr. Klugel acknowledged that the cost approach (at least as it was being used

by DFR) precluded consideration of market conditions. In consideration of this office glut, Mr. Klugel and DFR gave some thought to the use of the income approach to value, which would reflect the depression in the office market. Many in-depth discussions were held with the Corporation Counsel's office and the Associate Director of DFR to determine, in light of the depressed market, whether or not the income approach to value should be used for newly constructed office buildings having lease-up difficulties. Yet ultimately nothing came of it and no steps were taken to reflect actual market conditions. The Court concludes, at least under the circumstances of this case, that this failure to act was error.

7. Conclusion

Changes in market conditions such as a severe over-supply and under-demand can have a negative effect on the value of new buildings. Mr. Klugel was in agreement with the following statement found in the Encyclopedia of Real Estate Appraising, edited by Edith J. Friedman (1960) at p. 67:

> An estimate obtained by the Cost Approach may not reflect entirely the prevailing economic or market conditions. The cost of an improvement cannot be recovered in the market if there is no need for the improvement, if the property is not put to its highest and best use, if the structure is an over improvement or of poor design, or if rentals are reduced due to market conditions. (Emphasis supplied).

[quoted with approval in Medical Building Land Co. v. Department of Revenue, 203 Or. 69, 79, 80, and n. 11, 302 P.2d 416, 421, 422 and n.11 (1970)].

Mr. Klugel also was in concurrence with the principle set forth in Real Estate by Bloom, Weimer and Fisher, 8th edition (1962) at p. 435:

> The fundamental difficulty with the cost method, even in the case of new structures, is that the appraiser's view must of necessity be directed backwards rather than forward. The income method stresses future probable returns; the cost method may emphasize past or current experience of the property rather than its future. The original decision to construct a building may have been

> made at a time when it was justified by expectations; however, subsequent events may justify the original expectations or prove them to be in error. (Emphasis supplied).

Finally, Mr. Klugel agreed with language in The Appraisal of Real Estate, published by the American Institute of Real Estate Appraisers, 8th edition (1983) at p. 442, which in discussing the cost approach to value stated:

> Although markets tend toward equilibrium, market forces change. As the forces change, different points of equilibrium (or price) result. Shifts in supply and demand cause prices to increase or decrease. Thus, different values for the same property may result over time. If costs do not shift proportionately to price changes, the construction of buildings will be more or less profitable, and the value of existing buildings will increase or decrease commensurately.

Based upon the testimony of Mr. Harps and Mr. Spruill, the Court finds neither of their straight income and cost appraisal methods entirely reliable, and therefore rejects the assessments each has placed upon the subject properties for Tax Years 1983 and 1984. However, Mr. Harps testified at trial that he also made an appraisal based on a cost approach that factored in economic and functional obsolescence. Agreeing with respondent that petitioner's income approach is too speculative, and finding that petitioner's testimony as to the usefulness of calculating economic and functional obsolescence for appraisal purposes credible, the Court determines that Mr. Harps' recent appraisal utilizing both the cost approach and obsolescence factors the most fair and reliable of all the methods presented to the Court. In light of the fact that respondent must conduct an annual assessment, the Court finds Mr. Harps' assessment based on the cost approach with obsolescence calculations, as opposed to the income approach, the preferable of the two approaches to employ in determining the true market value. Thus Mr. Harps'

report supports an assessment of 1220 L Street, N.W., for Tax Year 1983 in the amount of $7,133,100.00 (land only) and for Tax Year 1984 in the amount of $16,053,433.00.

Wherefore, it is this 5th day of June, 1985,

ORDERED that the value of the subject property designated as Lot 42 in Square 284, for purposes of District of Columbia real property taxation for Tax Year 1983 is $7,133,100.00 (land only) and for Tax Year 1984 is $16,053,433.00; and it is

FURTHER ORDERED that respondent modify the assessment record card for the subject property to reflect the values here attributed to it for Tax Year 1984; and it is

FURTHER ORDERED that petitioner shall submit within ten days of the signing of this Order, through their expert Mr. Harps, a calculation representing the value of the subject property for Tax Year 1983, consistent with the Court's ruling that the building was under roof and using the same approach as Mr. Harps employed for the Tax Year 1984 calculation; and it is

FURTHER ORDERED that petitioner is entitled to a refund of the taxes paid, with interest, on the property to the extent that it was improperly overassessed by the District; and it is

FURTHER ORDERED that petitioner shall submit within twenty days of the signing of this Order a Proposed Order setting forth the amount of refund due for Tax Years 1983 and 1984 based on Mr. Harps' report utilizing a cost approach in conjunction with obsolescence factors.

JUDGE [illegible]

Copies to:

J. Hampton Baumgartner, Esquire
Stanley J. Fineman, Esquire
Charles A. Camalier, III, Esquire
1666 K Street, N.W., Suite 600
Washington, D.C. 20006

Julia L. Sayles, Esquire
Office of the Corporation Counsel, D.C.
1133 North Capitol Street, N.E., #238
Washington, D.C. 20002

Melvin Jones, Finance Officer, D.C.

APPENDIX

1220 L St. NW

COST APPROACH

Cost	=	$34,000,000
Less Land	=	- 7,000,000
Improvements	=	$27,000,000

1. Based on rent of $23.00 per sf average
2. And Rent up by end of 1983
3. Started Marketing - 11/81
4. Rent received - $15.00 per sq. ft.
5. Difference = $8.00 per sq. ft.

6.	Area of MRA	=	269,649 sq. ft.
7.	Area of Retail Space	=	12,505 sq. ft.
8.	Gross Area	=	290,956 sq. ft.

1220 L St. NW

CALCULATION OF EFFECT OF
LEASE ON INCOME AND VALUE

Facts

All annual rent in excess of annual expenses is net income. For example, if expenses for year 1 = $4.50 per sq. ft. without taxes, then all income above that figure is NOI.

If gross income	=	$15.00
And expenses	=	- 4.50
NOI	=	$10.50
Or if gross income	=	$23.00
And expenses	=	- 4.50
NOI	=	$18.50

And $23.00 - $15.00 = $8.00
And $18.50 - $10.50 = $8.00

Actual collectible rent for long term lease is $20.25 per year for first five years. The abatement for this lease was $2,200,000. The abatement in dollars per sq. ft. was $2,200,000/113,700 sq. ft. = $19.35.

If this $19.35 is spread over the first five years, the annual loss in rent is the amount of money that is lost per year at 13.5% interest. If the present worth is $19.35, the payment per year to equal $19.35 as a lump sum over a five year period is 1/5 of $19.35, plus the interest lost at 13.5%. This is calculated by using the partial payment factor for five years at 13.5%. That factor is 3.474743. And $19.35/3.474743 = $5.5687 or $5.57.

The contract rent was		$20.25
The loss is		- 5.57
The actual rent payable	=	$14.68 per sq. ft. per year.

The pro-forma for this property called for a rent beginning at an average of $23.00 per sq. ft. with full rent up by the end of 1983. And a rent of

1220 L St. NW

$20.00 per sq. ft. for the commercial with full rent up by the end of 1983.

The facts are that as of March 1985, no retail has been rented.

The rent used therefore for both the office space and the retail space is $14.68 per sq. ft. as the fair rent under the existing economic conditions and the conditions which existed on January 1, 1983. The loss for the first five years is then as follows:

	$23.00 - basis for cost
Less actual	-14.68
Loss for 113,700 sq. ft.	$ 8.32/sq. ft.
And 13,314 sq. ft. retail at	$20.00
Less	-14.68
Loss	$ 5.32/sq. ft.

This two year loss in commercial rent already exceeds the loss of $8.32 per sq. ft. for a five year period without interest, inasmuch as $5.32 loss x 2 = $10.64 for two years.

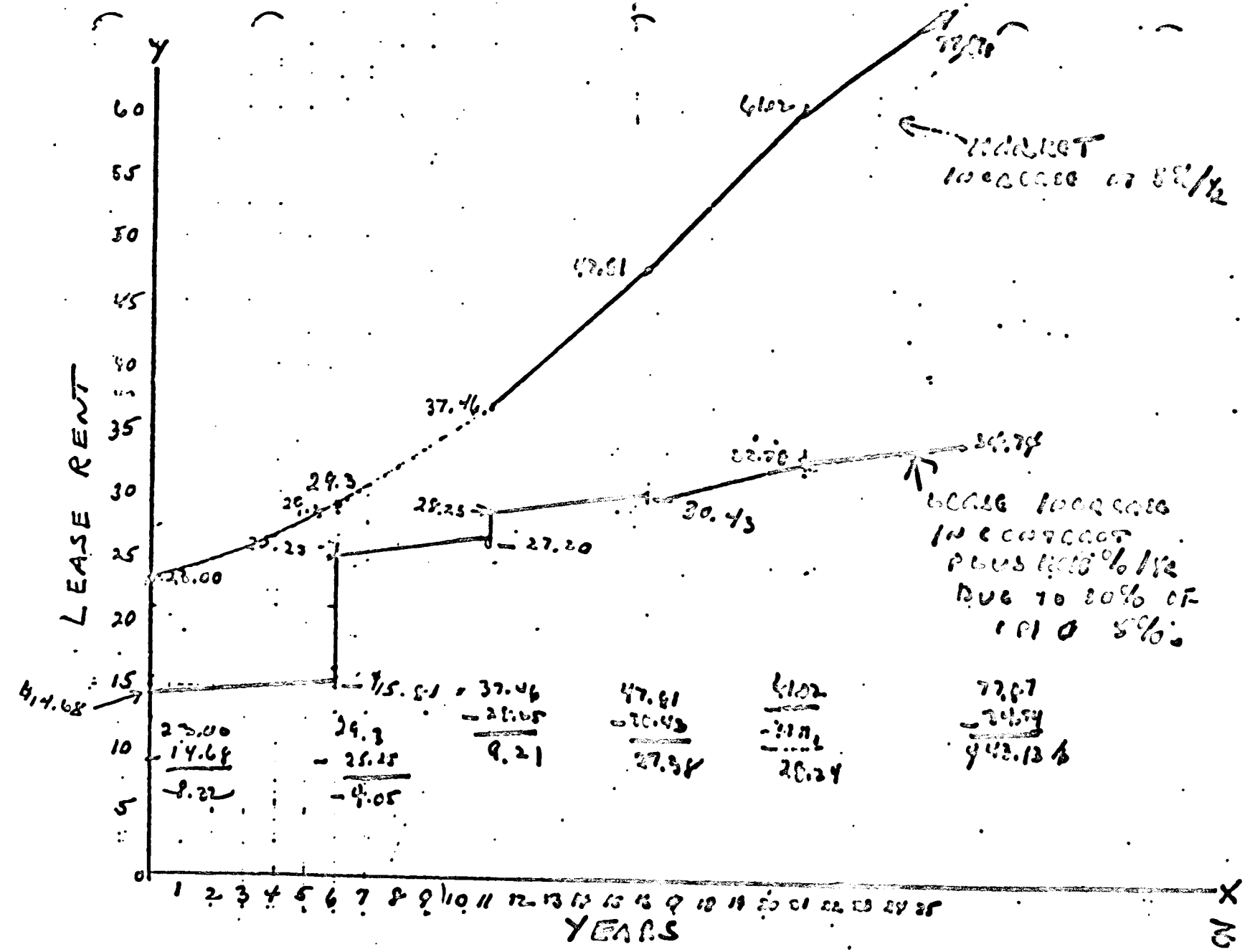
The remainder of the office space, not including the below grade space, is 143,949 sq. ft. All of this space is not rented as of March 15, 1985, however, if the rent is estimated the same as the long term lease for a five year period at $20.25 per sq. ft. with six months abatement, the loss in rent may be calculated as follows:

143,949 sq. ft. x $20.25/yr x 6/12	=	$1,457,424 abatement
And $1,457,424/143,949 sf	=	$10.13 in the first year.

However, the amount per year with interest at 13.5% to equal the present worth of $10.13 is $2.92 per year,

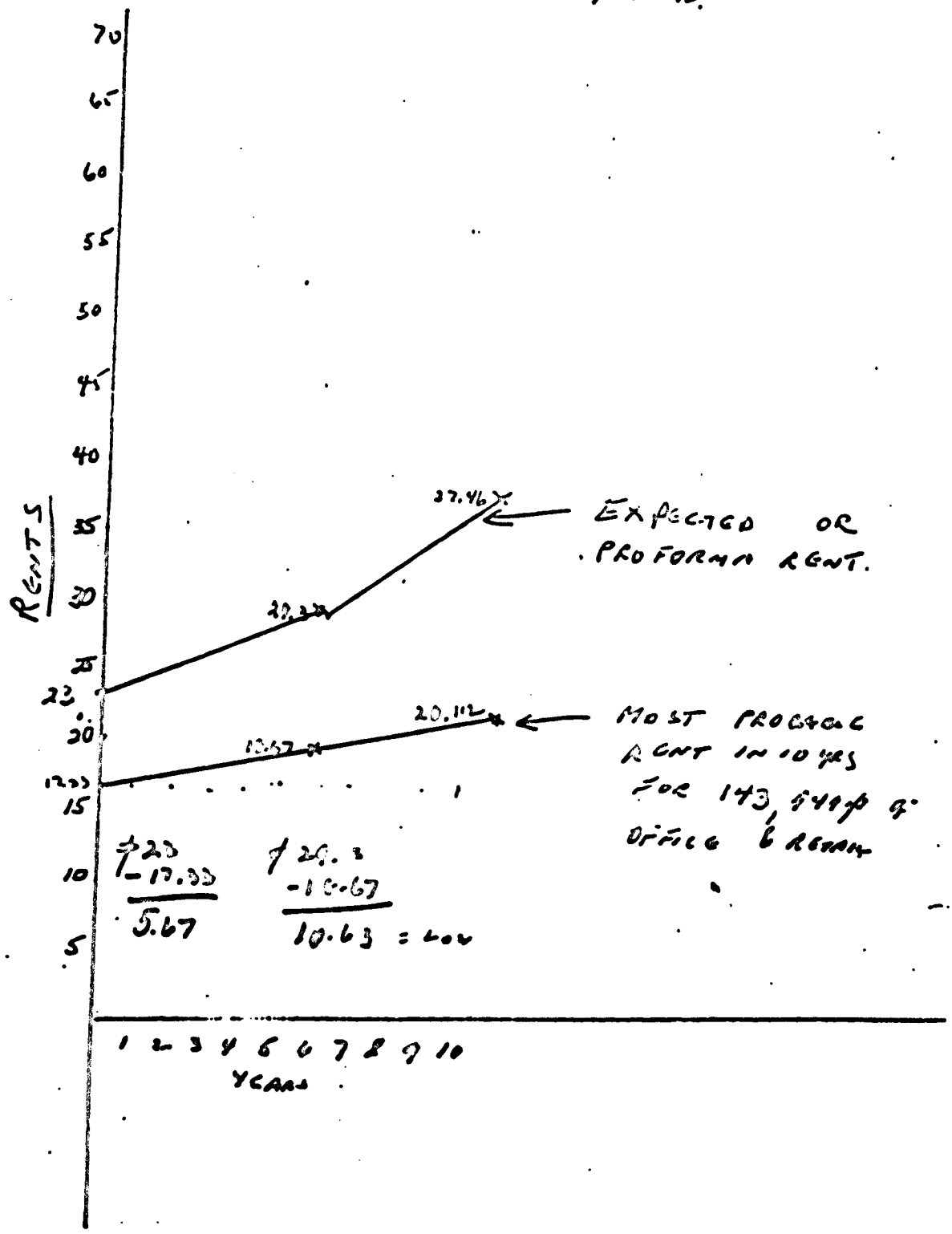
And	$20.25
Less	- 2.92
	$17.33/sf first five years before CPI

increase.


LEASE RENT
YEARS
X
Y
MARKET INCREASE AT 8%/12
LEASE INCREASE IN CONTRACT PLUS 1.5% /12 DUE TO 20% OF PAID 5%.
14.68
23.00
29.3
28.25
27.20
30.43
37.46
47.61
61.02
77.57
23.00
14.68
8.22
29.3
- 25.25
4.05
37.46
- 28.25
9.21
47.61
- 30.43
27.38
61.02
- 33.8
28.24
77.57
- 34.54
43.13

EXH 1

NO 2.


70
65
60
55
50
45
40
35
30
25
22
20
15
10
5
RENTS
37.46
EXPECTED OR PROFORMA RENT.
20.112
MOST PROBABLE RENT IN 10 YRS FOR 143,649 SQ. OFFICE & RETAIL
$23
-17.33
5.67
$20.3
-10.67
10.63 = LOW
1 2 3 4 5 6 7 8 9 10
YEARS

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The two graphs on the preceding pages illustrate the difference between the rent expected when the development was proposed and the rent obtained. Graph No. 1 illustrates the difference between the rent payable under the 25 year lease, and Graph 2 illustrates a probable trend of rent for the remaining 143,949 sq. ft. for a ten year period.

The overall rate used for the calculation of the economic value as if complete on January 1, 1983 was 13.5%. The same rate will be used as a discount rate. The rent loss for the first ten years only, will be estimated.

For the lease, the factor for the present value of $1.00 for five years is 3.475. Therefore:

1-5 yrs. - 113,700 sf x $3.32 x 3.475	=	$3,[illegible]
6-10 yrs. - 113,700 sf x $4.05 x 3.475 x .531	=	[illegible]
Loss in ten years from lease	=	$4,136,992

Loss from the 143,949 remaining sq. ft.:

1-5 yrs. - 143,949 sf x $5.67 x 3.475	=	$2,[illegible]
6-10 yrs. - 143,949 sf x 3.475 x $10.63 x .531	=	2,[illegible]
Loss	=	$5,659,703

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Total Economic Obsolescence:	=	$ 4,136,992
From Long Term Lease	=	5,659,785
From Remainder		
Total	=	$ 9,796,777

Functional Obsolescence

Cost of property is estimated at $7.50/sf more than it should have cost based on comparable costs And $7.50 x 290,956 sf	=	2,182,170
Physical Depreciation	=	None
Total Accrued Depreciation	=	$11,978,947
Cost Completed-new	=	$34,000,000
Less Land	=	- 7,000,000
Construction Cost	=	$27,000,000
Cost to complete	=	5,957,620 (page 30)
		$21,042,380
Less Accrued Depreciation	=	-11,978,947
		$ 9,063,433
Value of incomplete property as affected by accrued depreciation		+ 7,000,000 - Land
As of January 1, 1983	=	$16,063,433
Rounded	at	$16,060,000

William S. Harps, MAI, CRE