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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

JEFFERSON STANDARD LIFE INSURANCE COMPANY, and GIANT FOOD OF D.C., INC.,

Petitioners,

v.

DISTRICT OF COLUMBIA,

Respondent.

Tax Docket No. 3397-84

FILED

ORDER

This matter came before the Court for trial on February 6, 1986. Petitioners challenge the commercial real property tax assessment against the subject property, Lot 855 in Square 2580, located at 1751-1753 Columbia Road, N.W. for Tax Year 1984 pursuant to D.C. Code §§47-820, et. seq. At the time of the assessment, this was a Giant food store (it is now a Save Right food store). Upon consideration of the pleadings filed, the arguments of counsel, and the evidence adduced at trial, the Court makes the following:

FINDINGS OF FACT

1. Petitioner Jefferson Standard Life Insurance Company (hereinafter referred to as "Jefferson Standard") is a North Carolina corporation with an office at 101 North Elm Street, Greensboro, North Carolina 27240.

2. Petitioner Giant Food of D.C. Inc. (hereinafter referred to as "Giant") is a Delaware corporation with an office in the District of Columbia at 6300 Sheriff Road, Landover, Maryland.

3. In 1951, petitioner Giant owned the subject property. Giant sold it to petitioner Jefferson Standard, who leased it back to Giant for a term of 25 years. Subsequent to this sale leaseback transaction, successive "Extensions of the Lease" were executed by the parties as follows:

Lease Agreement Contract
January 29, 1951, through January 28, 1976

<u>25 year term:</u>

First 5 years	$37,500 per year
Second 5 years	$33,750 per year
Third 5 years	$28,125 per year
Remaining 10 years	$18,281 per year

Extension of Lease Agreement
March 27, 1975, through
January 28, 1979 $26,400 per year

Extension of Lease Agreement
September 28, 1979, through January 31, 1995
$37,00 per year

4. The lease and its extensions established fixed rentals. Under the present "Extension of the Lease," petitioner Jefferson Standard receives a fixed rent of $37,000 per year and a percentage rent which varies from year to year. There are no provisions for options to repurchase. Giant is obligated under the lease for taxes, maintenance, repairs, utilities, and insurance.

5. Petitioner Jefferson Standard has received from petitioner Giant the following amounts of percentage rent for the years indicated:

<u>Year</u>	<u>Amount</u>
3/79 - 2/80	$ 1,062
3/80 - 2/81	15,650
3/81 - 2/82	9,197
3/82 - 2/83	0
3/83 - 2/84	0

Thus, for Tax Year 1984, petitioner Jefferson Standard received only fixed rent of $37,000 and no percentage rent from the property for the tax year.

6. For Tax Year 1984, petitioner's property was assessed by George S. Toll as follows:

Land	$ 808,380
Improvements	271,620
Total Estimated Market Value	$1,080,000

At the Board of Equalization and Review, the petitioner alleged that the value of the subject property should be no more than $1,000,000. The Board, however, sustained the Tax Year 1984 assessment of 1,080,000. The resulting taxes were $23,004.

7. Petitioners timely paid the taxes due and filed suit for refund on March 30, 1984. Petitioners attached their $1,000,000 estimate of value to the petition. An appraisal report was later submitted and used at trial by petitioners, claiming the value of the subject property to be $565,000.

8. For Tax Year 1984, petitioners' expert witness, Ryland L. Mitchell, used the income approach to valuation.

9. The subject property contains 13,473 square feet. The gross building area is 16,940 square feet. The improvements, located at 1751-1753 Columbia Road were built in 1951. It is a one-story, plus partial basement supermarket. It is zoned C-2-B with a permitted FAR of 3.5.

10. Both Mr. Toll and Mr. Mitchell considered the highest and best use of the subject property to be its current use.

11. Michael Bush, a Giant employee, testified that the current lease was a new agreement, separate from the original lease under the sale leaseback transaction in spite of its title "Extension of the Lease." Mr. Bush testified that the current Extension of the Lease was an arms' length lease.

12. Petitioners' expert, Ryland L. Mitchell, testified (1) that the income approach to valuation rather than the reproduction cost should have been used; and (2) that the assessment on this property should have been reduced to reflect the long-term lease that permits it to rent the property far below market rates. He argued that the long-term

lease locked in the below market rents and reduced the value of the lessor's interest in the property.

13. Petitioners claimed that the District's assessments were too high because the assessor failed to take into account the depressing effects of the lease on the subject property. The lease, it was argued, reduced the value of the lessors' fee interests, because the lessor was locked into a long term at rents well below market rates. Petitioner further argued that the District of Columbia should have determined the value of this property as encumbered by using the contract rent and the rent during the option years.

14. Mr. Mitchell testified that he did not use the cost approach to valuation because of the age of the improvements, the difficulty in estimating depreciation, and because, as improvements increase in age, the cost approach loses its relevancy. He considered the market data approach to valuation inappropriate because he believed insufficient information existed for its development, and in this case, the market approach might indicate a "free and clear" value for the subject which would not take into account the existing lease.

15. Relying upon the income approach to valuation to estimate the fair market value of the subject property, as encumbered by the existing lease, Mr. Mitchell estimated the present worth of the income stream and reversion of the property at the end of the lease. The monthly rent of the subject property was to remain constant at $3,083.33 for the remaining 145 months (January 1, 1983, through January 31, 1995) without consideration of percentage rent which had not been recently generated. The present worth of one per period factor at 15% for 145 months was 66.793. He multiplied the

monthly rent times this factor, and developed a rounded present worth of the anticipated income stream of $206,000. For the reversion, he assumed that the assessor's current free and clear value estimate of $1,080,000 was correct. He extended this amount to the end of the lease term of 145 months by increasing the present value at the compound annual rate of 6%. In his opinion a 6% per year compound rate was indicated as the average rate of increase experienced by real estate over the last 20 years. He stated that his calculations resulted in a free and clear value of the subject property at the end of the lease term at a rounded total of $2,175,000. This amount was multiplied by the present worth of one reversion factor at 15% for 145 months of 0.165. The multiplication produced a present worth of the reversionary value of the property of $359,000. As a final step, he added the present worth of the income stream and the reversionary value of the property together developing a total of $565,000 which represented the value of the leased fee estate of the subject property.

16. Mr. Mitchell testified that he neither checked the equalization of the subject property with other properties nor investigated comparable rents.

17. The respondent's assessor, George S. Toll, testified that $30,000 of permit conversion renovation work was performed in July, 1982. He made a physical inspection and found that the subject property was converted from a Giant to a Save Right store (another supermarket).

18. Mr. Toll testified that the contract rent in a long-term lease or sale leaseback transaction is usually less than comparable market rents. He added that income from the lease

only would not be indicative of the total value of the property inasmuch as he was charged with valuing the fee simple estate. Although he stated that he had seen petitioner's income and expense statements prior to the valuation date of January 1, 1983, he did not consider the income reported as evidence of estimated market value because only the lease income was revealed. The actual lease was not submitted before his assessment.

19. Mr. Toll testified that the reproduction cost approach to value was the appropriate method to utilize. The cost approach was used because the subject grocery store was considered unique, specialized or special purpose property. Mr. Toll stated that it is standard practice at the Department of Finance and Revenue to assess special purpose, unique, new or relatively new properties by using the reproduction cost approach to value.

20. The assessor testified that he did not use the market data approach to valuation because there were insufficient sales of comparable special purpose property. He rejected the income approach to valuation because the income information on the income and expense forms revealed only income from the lease. The financial information available did not permit a determination of market rents necessary for the use of the income approach to valuation.

21. Mr. Toll's use of the reproduction cost approach to valuation involved finding the reproduction cost of the improvements less depreciation and adding that to the land value estimated through the use of comparable land sales. Such land values were then equalized with surrounding similar land. The major steps in applying the cost approach, which

the District's assessor followed, are as follows:

a. Estimating the cost of reproduction of the improvements as of the date of appraisal;

b. Estimating the amount of depreciation present in the improvements;

c. Deducting depreciation from reproduction cost to arrive at an indicated value of improvements;

d. Estimating the market value of the land and adding it to the improvement value to arrive at an indication of total market value.

22. Mr. Toll obtained cost information from the Marshall and Swift cost guide. The use of the Marshall and Swift Computer Cost Service, utilized by the District's assessor, is also recognized for implementing the cost approach. Id. 106. He testified that the improvements component of the subject assessment was obtained through the utilization of the Marshall and Swift Valuation Service (the appropriate pages used to make the assessment were submitted as trial exhibits). The precise amount was determined as follows:

Floor	Floor area	Sq.ft. rate	Time adj.	Loc. adj.	Perimeter adj.	Height adj.	Depreciation percent
1st	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	54
basement	4,460	11.50	1.01	.99	1.045	.947	54

The renovations generated additional economic life for the subject property.

23. Mr. Toll testified that he did not have to make his own estimate of depreciation because the Marshall and Swift Cost Manual has a table on depreciation which he used.

24. The land value for the assessment of Lot 855, Square 2580 was determined primarily, but not exclusively

from the analysis of the following sales which occurred in the 18th Street Columbia Road commercial district:

Sq.	Lot(s)	Date	Price	Area	Price per sq. ft	Zoning
2549	628, 629 630	6/23/81	$257,500	4204	$61.24	C2B
2560	82	11/20/79	$94,000	1656	$56.76	C2B
2560	105, 106	7/28/80	$194,750	3068	$63.48	C2B

The deed recordation forms of the above transactions were used at the time of the assessment.

25. Mr. Toll testified that for Tax Years 1983 and 1984 he also was the assessor for the Safeway supermarket property next door to the subject property. He stated that he also had used the reproduction cost approach to value for that property because it was also characterized as special purpose property for which only lease income information was available. The same price per square foot was placed on the subject property and Safeway for Tax Year 1984.

26. Mr. Toll testified that he took into account the equalization of the subject property with the Safeway property next to it in order to assure a fair tax burden among the properties.

CONCLUSIONS OF LAW

D.C. Code, 1981, ed., §47-802(4) provides the definition of "estimated market value" for District of Columbia real property assessment and tax purposes as follows:

> (4) The term "estimated market value" means 100 per centum of the most probable price at which a particular piece of real property, if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would be expected to transfer under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other.

D.C. Code, 1981 ed., §47-820(a) provides that in determining estimated market value any factor having a bearing on market value must be considered. There is no statutory or common law mandate that respondent must follow any one particular approach in valuing real property in this jurisdiction. D.C. Code, 1981 ed. §47-820 provides as follows:

> In determining estimated market value for various kinds of real property the Mayor shall take into account any factor which might have a bearing on the 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.

As to the first factor in §47-820, "sales information," the regulations specify that "sales which represent arms length transactions between buyer and seller shall be used in analyzing market values." 9 DCMR §307.3. The third statutory factor, "reproduction cost," the Council said, could be estimated by two methods: by "either (1) adjusting the property's original cost for price level changes or (2) applying current prices to the property's labor and material components and taking into account any other costs typically incurred * * *." The replacement cost must then be reduced by "the amount of depreciation or estimated loss of value because of age, condition, or other factors." §307.4. The assessor properly followed these guidelines.

The regulations further give the Director of the Department of Finance and Revenue considerable discretion in chosing the approach to valuation when evaluating any given property; he may use "one or more of the generally recognized approaches to valuation set forth in this section or any other method the Director deems necessary to arrive at estimated market values." 9 DCMR §307.2. The "generally recognized" methods of valuation set out in the regulations are the "comparable sales approach," the "replacement cost approach," and the "income approach." 9 DCMR §§307.3; 307.4; 307.5.

It is the petitioners' burden of proof to provide evidence sufficient to prove that assessments are arbitrary, excessive or otherwise erroneous and unlawful. Superior Court Tax Rule 11(d). See also, 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 simply present an alternative measure of value. To provide a basis for invalidating an assessment, petitioner must show the assessed value has been erroneously determined.

The Court concludes that petitioners failed to demonstrate that respondent made an erroneous determination of property value. Consequently, petitioner did not meet its burden of proof. Respondent has presented a value based upon an approach based in law and logic; the value concluded through the use of the reproduction cost approach to valuation was shown to be reasonable.

Petitioners also have not carried their burden of proof (1) that an income approach to valuation rather than the reproduction cost approach to valuation should have been used, and (2) that the assessment on the property should have been reduced to reflect the long term lease that permits petitioners to rent the property far below market rates.

The Court finds that petitioners' use of the income approach to value was improper given the insufficient income revealed and Mr. Toll's testimony that income from the lease was a measure of only part of the value of this property. Mr. Mitchell's application of this approach was flawed: only a portion of the property interest in this property was valued, the leased fee, while the leasehold interest was ignored entirely. The portion of the property that was appraised was not indicative of the market and the appraisal report contains little substantiation or references to sources for the figures and percentages used.

The Court is also persuaded that it is not axiomatic that the assessment must be reduced because of the long-term lease locking in a lower rental value on the property. The value of all interests in the property must be evaluated because the assessor is obligated by state to value the fee simple interest in the property.

Moreover, whether the subject lease is characterized as the result of a sale leaseback or simply as a lease, the approach chosen by the assessor was appropriate. The Department of Finance and Revenue and Mr. Toll were operating within their discretion in using the cost approach to value since other approaches were inappropriate in these circumstances. The use of this approach is generally preferred where data from other approaches is not reliable (income from a sale leaseback, or lease) or non-existent (lack of comparable sales).

The District of Columbia assessors validly rejected the income approach to value in this case because it does not reflect market value in sale leaseback situations, or lease situations where only income from the lease is available. A property owner who receives below market rent in a sale leaseback transaction, or under a lease should not obtain a lower assessment and lower taxes than one who receives fair market rental.

The fact that income from a sale leaseback or lease is not normally reliable evidence of market value is also supported in Friedman's Encyclopedia of Real Estate Appraising. (2nd printing 1970):

> The sale and leaseback is a method of long-term financing used for all types of income-producing property. It has become common practice for an owner to sell property that he is occupying for his business, and take back a long-term lease. Frequently, the rental provided in the lease is less than the current market rent, and the leasehold may therefore have a substantial value which an appraiser may be called upon to estimate. (Id. at 672)

The 1951 lease pursuant to the sale leaseback arrangement and the subsequent "Extensions of the Lease" are inseparable in that petitioners themselves entitle these subsequent documents as "extension." Such inseparability makes this case and the Safeway cases (Safeway Store, Inc. v. District of Columbia, Tax Docket Nos. 3221-83 through 3228-83) somewhat comparable. Both are commercial food stores. In the Safeway cases, the assessors used the cost approach to valuation in a sale leaseback situation, whereas petitioners' experts used the income approach to valuation. There, as here, the Court finds that the most appropriate method of valuation in a sale leaseback situation should be the reproduction cost approach to valuation because the subject is special purpose property and the income from the lease in such situations is not representative of the market value of the property.

The original lease of which the current lease is an extension involved a "sale and leaseback" by Giant. Such arrangements do not ordinarily reflect current market values even at the time they are signed. They often bear only a fortuitous relationship to market rents, because a sale and leaseback is ordinarily simply an alternative means to finance property for a corporation. See generally Frank Lyon Co. v. United States, 435 U.S. 561 (1978); [illegible]urtz, A Decision Model for Parties in Sale-Leasebacks of Real Estate, 28 William and Mary L. Rev. 385, 388-392 (1982); Fuller, Sales and Leasebacks 48 Geo. Wash. L. Rev. 60, 64 (1982). Where rents do not represent current market or current values, they are not helpful in valuation for assessment purposes. Board of Supervisors of Fairfax County v. Nassif., 290 S.E.2d 822, 825 (Va. 1982). In the instant case, Mr. Toll testified that he and his office do not view such rents as reflective of market rents. Mr. Mitchell offered no opinion on this question.

Several neighboring jurisdictions have refused to rely upon sale leaseback transactions as evidence of market value. City of Atlantic v. County Board of Review, 234 N.W. 2d 880 (1975) quoting L. Bamberger & Co. v. Division of Tax Appeals, 57 A.2d 242, 244, aff'd, 62 A.2d 309 (N.J. 1948) stating "The transaction is more in the realm of financial convenience than a transaction between a simple buyer and seller."

In City of Atlantic v. County Bd. of Review, supra, Safeway Stores, Inc. acquired property for a new supermarket in Atlantic, Iowa. Shortly after completion of construction and occupancy, Safeway sold the property to a bank. At the same time, Safeway and the bank entered into a leaseback arrangement whereby Safeway leased the property for 20 years with renewable options. The lease required Safeway to pay all taxes, maintenance and upkeep. The bank, in turn, recouped its entire investment ($665,000 sales price) plus 9% at the end of the 20 year lease term.

The county assessors set the actual value of the grocery store for tax purposes at $336,162. Safeway filed a protest with the local board of review, seeking to raise the value.

Both the Board and the trial court affirmed the assessor's value.

On appeal the Supreme Court of Iowa, under a statute defining actual value of real property as its fair and reasonable market value, held that the sale by Safeway to the bank was not a normal sale which could be relied upon for market evidence. Moreover, it upheld the county's expert witness' method of valuation--primarily the cost approach. The county's expert considered the income approach, but rejected it (as did the courts) because the sale leaseback involved in these cases should also be considered to be abnormal and rejected or given little weight.

The cost approach to value adopted by the Iowa board and courts in a sale leaseback transaction was also adopted by a New Jersey court in L. Bamberger & Co. v. Division of Tax Appeals, supra.

Even had comparable properties been available, they would not have to have been encumbered with a long-term lease which petitioner states must be taken into account. Put another way, the existence of a favorable or unfavorable lease does not destroy the ability of the tax assessor to compare the encumbered properties with similar properties when such are available which are not so encumbered. As the Arizona Supreme Court held:

> The fact that an unfavorable lease may make the property less desirable to prospective buyers does not affect its full cash value for taxation. (citing Swan Lake Moulding v. Department of Revenue, 478 P.2d 393 (Or. 1970)).
>
> It is the value of the real property itself that is to be determined and the voluntary alienation of a leasehold interest does not destroy the comparability of the sale of other properties not similarly encumbered. The combined value of the lessor's and lessee's interests under a long-term lease is subject to taxation. Any equitable apportionment of the tax burden between the parties to the lease cannot be attributable to the taxing statute. Caldwell v. Department of Revenue, 122 Ariz. 519, 596 P.2d 45 (1979).

See also Yadco, Inc. v. Yankton County, 237 N.W.2d 665 (S.D. 1975); Rowland v. City of Tyler, 5 S.W.2d 756 (Tex. 1928); Petition of Ernst 58 Misc. 504, 295 N.Y.S.2d 712 (1968).

Virtually all courts have rejected the contention that, because a long term lease at unfavorable rates reduces the value of the fee interest held by the owner (and the amount a willing buyer will pay for it), real estate taxes must be reduced. The primary rationale for the decisions is that the base for computing the property tax includes more than the leased fee interest; it includes all interests in the property. See, Youngman, Defining and Valuing the Base of the Property Tax, 58 Wash. L. Rev. 713, 718-33 (1983).

The Court is persuaded that petitioner has failed to meet its burden of proof and the District's assessor properly implemented the reproduction cost approach to valuation of the special purpose subject property. The Tax Year 1984 assessment of $1,000,000 was not excessive or arbitrary.

Wherefore, it is this 30th day of May, 1986,

ORDERED that respondent's assessment for Tax Year 1984 for the property known as 1751-1753 Columbia Road, N.W. (Lot 55 in Square 2580) is hereby affirmed.

JUDGE IRALINE G. BARNES

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