

*Opinion Book*

*Opinion No.  
1276*

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA  
TAX DIVISION

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TAX DIVISION

AUG 24 1989

FILED

L'ENFANT PLAZA PROPERTIES, INC., :  
et al. :  
: Petitioners :  
: v. :  
DISTRICT OF COLUMBIA :  
: Respondent :

Tax Docket No. 3806-86

ORDER

This case came on to be heard before the Court on April 10, 1989. Upon the Petition filed herein, as amended, the Stipulations between the parties and upon consideration thereof and the evidence adduced at trial, the Court having entered Findings of Fact and Conclusions of Law, it is by the Court this 23rd day of August, 1989, hereby

1. ORDERED, that Respondent be and hereby is, directed to reduce the assessment on Lot 866 in Square 387 for purposes of District of Columbia real estate taxes for Tax Year 1986 from \$33,585,000 to \$23,200,000 consisting of \$13,659,624 for the land and \$9,540,376 for the improvements.

2. ORDERED that the Respondent cause the assessment record card for Tax Year 1986 on Lot 866 in Square 387, to be altered to reflect this Court's determination that the estimated market value of this property for purposes of the District of Columbia real property taxation from \$33,585,000 to \$23,200,000.

3. ORDERED, that the correct real estate tax on Lot

866 in Square 387 for Tax Year 1986 is \$470,960.00.

4. ORDERED, that the Respondent be and hereby is, directed to refund to Petitioners Tax Year 1986 real estate taxes on Lot 866 in Square 387 in the amount of \$210,815.50 with interest on the first-half taxes of \$105,407.75 from the date of payment on September 15, 1985 to the date of refund, and interest on the second-half taxes of \$105,407.75 from the date of payment on March 31, 1986 to the date of refund, at the rate of six (6) percent per annum, the statutory rate as provided by law.

  
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JUDGE

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Petitioners :

v. :

Tax Docket No. 3806-86

DISTRICT OF COLUMBIA :

Respondent :

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter came before the Court for trial on April 10, 1989. Petitioners, the fee simple owners of real property located at 400 10th Street, S.W., Lot 866 in Square 387 (hereinafter the "subject property") challenged the real property tax assessed against the subject property for Tax Year 1986 pursuant to D.C. Code § 47-820 (1981 ed.). Respondent, the District of Columbia, valued the subject property for tax assessment purposes for Tax Year 1986 at \$33,585,000, consisting of \$13,659,624 for land and \$19,925,376 for improvements. Petitioners appealed to the Board of Equalization and Review, which sustained the assessment. Petitioners timely paid the tax of \$681,775.50 and timely filed this appeal.

The Court exercised jurisdiction over this appeal pursuant to D.C. Code §§ 47-825 and 47-3303 (1981 ed.). Based upon the evidence presented at trial and stipulations of the parties, the Court makes the following findings of fact and conclusions of law.

## FINDINGS OF FACT

1. The subject property is located at 400 10th Street, S.W., Lot 866, Square 387 in the District of Columbia.

2. Petitioner L'Enfant Plaza Properties, Inc. (hereinafter referred to as "L'Enfant Plaza") is the successor by merger, as of June 30, 1974, to L'Enfant Plaza North, Inc. Both corporations are or were incorporated in and operating in the District of Columbia. The principal office of both corporations is or was 490 L'Enfant Plaza East, S.W., Washington, D.C. L'Enfant Plaza is the owner of the improvements and lessee of the subject property, Lot 866 in Square 387, in the District of Columbia, improved by premises known as 400 10th Street, S.W.

3. Petitioner, L'Enfant Plaza Corporation is a corporation organized and existing under the laws of the District of Columbia with a principal place of business at 490 L'Enfant Plaza East, S.W., Washington, D.C. L'Enfant Plaza Corporation is the owner of the subject real estate, Lot 866 in Square 387.

4. Petitioners are obligated to pay all real estate taxes assessed against the subject property.

5. Respondent District of Columbia is a municipal corporation, created by the United States Congress, Section 1-101 of the District of Columbia Code.

6. Lot 866 in Square 387 is referred to as the subject property.

7. On or about March 1, 1985, Petitioners received a notice of assessment dated February 27, 1985 stating that the

assessment on the subject property for Tax Year 1986 was \$27,023,589.

8. On or about April 1, 1985, Petitioners received a purported "corrected notice" of assessment dated March 27, 1985 stating that the assessment on the subject property for Tax Year 1986 was \$33,585,000.

9. The appeal to the Board of Equalization and Review in Appeal No. 86-667 was timely filed on April 15, 1985. After oral hearing, the Board of Equalization and Review, by decision dated May 31, 1985, informed Petitioners of its decision to sustain the assessment at \$33,585,000.

10. The taxes and assessment in controversy are real estate taxes and assessment for Tax Year 1986 in the following amounts:

Total Assessment:	\$33,585,000.00
Total Taxes:	\$ 681,775.50

11. The Tax Year 1986 taxes in the amount of \$681,775.50 were timely paid in full. The first-half taxes in the amount of \$340,887.75 were timely paid on September 15, 1985 and second-half taxes in the amount of \$340,887.75 were timely paid on March 31, 1986.

12. The subject property contains 51,741 square feet of land with primary frontage on 10th Street, S.W. The site is zoned UR. The subject property is improved with a nine story office building, completed in 1968. Both parties agree that the current use of the subject property is its highest and best use.

13. The building contains approximately 409,636 square feet of gross building area of which 280,262 square feet are rentable area. Approximately 24,556 square feet of the net rentable area is commercial space, 251,238 square feet is office space, and 4,468 square feet is storage space.

14. At the outset of the trial, counsel for Respondent conceded that the assessment for Tax Year 1986 was invalid. Therefore, the only issue at trial was the correct market value of the subject property as of January 1, 1985.

15. Petitioners called Mr. Donald V. Urquhart, M.A.I., S.R.P.A. as their first witness. Counsel for Respondent stipulated to his qualifications and he was qualified by the Court as an expert witness. Mr. Urquhart testified as an expert as to the value of the subject property.

In his valuation of the subject property, Mr. Urquhart considered all three methods of valuation, the cost approach, the comparable sales approach and the income capitalization approach. He determined that the cost approach was not applicable. Mr. Urquhart used primarily the income capitalization approach in valuing the subject property, also examining sales in the District of Columbia.

After a detailed examination of the operating history, Mr. Urquhart derived a stabilized gross income for the subject property based upon market and contract rents. Mr. Urquhart testified that he then deducted from the stabilized gross income, a stabilized figure for vacancy and credit loss and concluded a stabilized effective gross income of \$5,984,950.

Mr. Urquhart then examined the expenses of the subject property and market expenses for other properties with which he was familiar. Mr. Urquhart testified that the building was established and therefore had a stable expense history. Mr. Urquhart also testified that, in stabilizing the expenses for the subject property, idiosyncrasies of the subject property had to be taken into account. Mr. Urquhart concluded from his analysis that the stabilized operating expenses for the subject property would be \$8.87 per square foot for a total of \$2,484,900.

The stabilized operating expenses were then deducted from the stabilized effective gross income to yield a net operating income of \$3,500,050.

16. In concluding his value for the subject property from the income capitalization approach, Mr. Urquhart derived a capitalization rate from the local Washington, D.C. market and from the nation-wide publications which publish capitalization rates derived from sales. As investors would be the willing buyer portion of the willing buyer/willing seller analysis, Mr. Urquhart testified that he also examined investments which would compete with real estate for investors' dollars, including their rates of return and risk.

From this examination of national and local trends and competing investments, along with his familiarity with the local market, Mr. Urquhart concluded a capitalization rate of 12.06%. To this rate Mr. Urquhart added the tax rate for Tax Year 1986, of \$2.03 per \$100 of assessed value, to yield a total capitalization rate which he rounded to 14.0.

17. Mr. Urquhart concluded a value for the subject property as of January 1, 1985 using the income approach of \$25,000,000. This value was obtained by applying his total capitalization rate of 14.0 to the stabilized net operating income of \$3,500,050, yielding a result of \$25,000,000.

18. After reaching a result by capitalizing the stabilized net operating income, Mr. Urquhart deducted an allowance for leasing up the space that would become vacant in 1985. Mr. Urquhart testified that, during calendar year 1985, 90,437 square feet would become vacant. Significant losses would be experienced which must be deducted from the purchase price of the property. Mr. Urquhart testified that the total lease-up costs would be \$2,320,000.

With regard to the rent loss, Mr. Urquhart conservatively estimated a six month lease-up which resulted in an allowance of \$711,371, rounded to \$700,000. Mr. Urquhart also testified that leasing commissions would be \$90,000 and building renovation costs would be \$1,530,000.

Mr. Urquhart testified that he deducted the total lease-up costs of \$2,320,000 from the value if fully leased of \$25,000,000, to yield the market value of the property as of January 1, 1985 of \$22,680,000 rounded to \$22,700,000.

19. Finally, in testing his conclusion of value for the subject property, Mr. Urquhart completed a cash flow analysis of the subject property. Applying the stabilized net operating income he had derived for the subject to the real estate taxes and mortgage requirements at the then-prevailing



market rates for mortgages, Mr. Urquhart concluded that, if an investor purchased the property for the value that he ascribed to it, the property would have a positive cash flow sufficient to render it competitive in the market place for investors' dollars.

20. Respondent presented a single witness, Mr. Anthony Reynolds, M.A.I. Mr. Reynolds' qualifications were stipulated and he qualified as an expert witness.

Mr. Reynolds testified that he examined all three approaches to value but that he, like Mr. Urquhart, disregarded the cost approach. Mr. Reynolds testified that he used both the income capitalization approach and the comparable sales approach but relied on the income approach; however, he failed to consider contract rents and actual costs in computing his income. He failed to properly consider actual vacancies and made contradictory assumptions in his stabilized income and expenses. Mr. Reynolds arrived at a stabilized net operating income (before real estate taxes) of \$3,475,000, rounded.

21. During cross-examination by Petitioners' counsel, Mr. Reynolds examined the cash flow of the subject property if Mr. Reynolds' income and expense conclusions were applied. Mr. Reynolds admitted that, under market conditions as of the value date, his analysis would yield a negative cash flow after debt service. A willing buyer would not buy subject property at Mr. Reynolds' value yielding a negative cash flow after debt service. This is prima facie proof that Mr. Reynolds' valuation is not full market value.

22. Petitioners also called a rebuttal witness: Joyce Hoffman, Controller of L'Enfant Plaza Properties. Ms. Hoffman testified that the vacancy actually experienced in 1985 was an average of 50,000 square feet throughout the entire year. Ms. Hoffman also testified that the rents for new leases went down from an average of \$22 per square foot to \$21 per square foot in 1986. The reduction in rent was an effort to attract tenants.

#### ANALYSIS AND CONCLUSIONS

Superior Court review of a tax assessment is de novo, necessitating competent evidence to prove the matters at issue. Wyner v. District of Columbia, 411 A.2d 59 (D.C. App. 1980). The correct assessment of the subject property for Tax Year 1986 is the present market value as of January 1, 1985.

The Respondent conceded that the assessment was incorrect as made. The Court, therefore, concludes that the assessment was invalid.

The Court finds that Petitioners' expert was more credible than Respondent's expert and that Petitioners provided credible evidence as to the value of the subject property for Tax Year 1986. Upon review of the testimony and documentation presented, the Court concludes that income analysis was properly performed by Petitioners' expert, thereby producing an estimate of market value.

The District of Columbia Court of Appeals has consistently held that all three approaches to value must be considered. District of Columbia v. Washington Sheraton Corp.,

499 A.2d 109, 113 (D.C. 1985); Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207 (D.C. 1987). Both the Taxpayers' expert and the District's expert examined but rejected as inapplicable two of those approaches, the cost approach and the comparable sales approach.

Consideration of the contract rent is required in determining the fair market value of the property using the income capitalization method. L'Enfant Plaza Properties, Inc. v. District of Columbia, Tax Docket 3650-85 ( September 20, 1988; Barnes, J.). In the instant case, only Taxpayers' expert, Mr. Donald Urquhart, considered both the contract and market income and expense. The District's expert, Mr. Reynolds, ignored the actual income and expenses and vacancy of the subject property. In addition, Mr. Reynolds made contradictory assumptions in determining his stabilized income and expenses for the subject property.

When determining the "market rent" for the subject property, Mr. Reynolds did not factor in any allowance for rent abatements or reductions to lure tenants to this older building in Southwest Washington during an office supply glut. Thus Mr. Reynolds' stabilized gross income after a vacancy allowance, in the amount of \$5,769,753 was excessive and derived in violation of the controlling legal precedent regarding the income capitalization method.

In calculating his stabilized expenses for the subject property, Mr. Reynolds made several sets of inconsistent assumptions. For example, Mr. Reynolds testified that the

subject property had been particularly well managed; because of this good management, the expenses had been minimized and the income maximized. In addition, the inefficient design of the subject property required more personnel to operate it. Despite these two valid assumptions about the subject property, when Mr. Reynolds stabilized the management expenses for the subject property, he stated that those expenses could be reduced and he therefore stabilized them at a much lower rate than the actual historical management expenses. Thus, Mr. Reynolds' stabilized expenses in the amount of \$2,293,000 were understated. From this overstated gross income and understated expenses, Mr. Reynolds derived a net operating income before real estate taxes of \$3,475,000.

Taxpayers' expert, Mr. Donald Urquhart, was more credible in that he closely examined both the actual operating experience of the subject property and the market experience as of the valuation date. Mr. Urquhart examined each lease in effect in the subject property as of the valuation date. Mr. Urquhart examined properties located in the immediate vicinity of the subject property to determine a market rent as of the valuation date. After having closely examined these factors, Mr. Urquhart determined a stabilized gross operating income for the subject property, after vacancy and credit allowance, in the amount of \$5,984,950.

In determining his stabilized expenses for the subject property, Mr. Urquhart closely examined the actual operating history of the subject property and market experience of similar

properties for operating expenses. As the subject property was established and had a stable operating history, Mr. Urquhart examined the actual operating statements, rent rolls, leases and pass-throughs to the tenants. He also examined the operating history of similar buildings with which he was familiar. Expenses in the amount of \$2,484,900 were then subtracted from the gross income for a net operating income before real estate taxes of \$3,500,050.

After concluding their net operating incomes for the subject property, both experts determined a capitalization rate. Mr. Reynolds testified that he derived his capitalization rate from sales and from the statistics of the American Council of Life Insurance (ACLI). But Mr. Reynolds admitted in his testimony that there were no comparable sales to the subject property and, when the tables of the ACLI were actually examined, Mr. Reynolds' capitalization rate of 10.5% could not be found.

The Court concludes that Taxpayers' expert's method of computing the capitalization rate was more credible than the District's expert's method. Mr. Urquhart testified that he derived his capitalization rate from a wide range of local and national investment, lending and market indicators. As real estate was merely one investment competing for investors Mr. Urquhart closely examined the subject property as compared with other investments available during the relevant time period. Using this investment analysis, together with established capitalization rates and interest rates from mortgages at the

time, Mr. Urquhart derived a capitalization rate of 12.06% which he applied to the subject property. As the net operating income had been calculated before the payment of real estate taxes, the real estate tax rate was then added to this capitalization rate for a total overall capitalization rate of 14.0%.

After reaching a value by capitalizing his stabilized net operating income, Mr. Urquhart deducted an allowance for lease-up in recognition of the large amount of space that would become vacant in 1985. Mr. Urquhart allowed \$700,000 for rent loss, \$90,000 for leasing commissions and \$1,530,000 for renovations. The Court concludes that Mr. Urquhart's allowance for lease-up is reliable with the exception that his allowance for renovations is overly generous. The Court finds that \$1,000,000 for this expense is more reasonable.

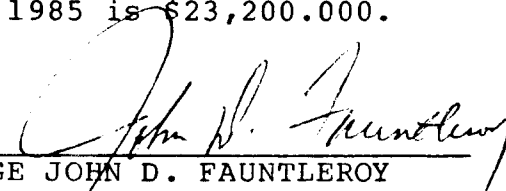
Mr. Reynolds completely failed to account for the fact that more than 88,000 square feet would become vacant on March 31, 1985. While he admitted that there was a "massive vacancy" of up to 125,486 square feet (44.8%) during the year, he only took a vacancy allowance of 5%. Mr. Reynolds did not make any allowance for excessive rent loss, leasing commissions or renovation of the vacated space. Thus, Mr. Reynolds completely ignored the substantial vacancy actually experienced by the property.

Mr. Urquhart tested his concluding value by applying a cash flow analysis. As both experts acknowledged, a willing buyer of real estate would examine the cash flow of the property before he determined the price at which he would purchase it.

Mr. Urquhart testified that, for value placed on the property by the District's expert, the subject property would have negative cash flow. This is prima facie proof that a willing buyer would not buy the subject property at Mr. Reynolds' value. Mr. Urquhart's valuation, however, would yield a positive cash flow after debt service.

The Court concludes that the method of deriving value from the capitalization of income method as applied by Mr. Urquhart was more reliable and a better indicator of value than the method applied by Mr. Reynolds.

The fair market value of the subject property as of January 1, 1985, is most appropriately determined by the use of the income capitalization method, the actual income and expenses of the subject property must be considered. As the Respondent's expert did not consider the actual net operating income, specifically the substantial vacancy, of the subject property, the value arrived at is invalid and does not represent fair market value. The taxpayers' expert was the only witness who took into account the actual income and expenses and vacancy of the subject property. Therefore, this Court concludes that fair market value of the subject property as of January 1, 1985 is \$23,200,000.

  
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JUDGE JOHN D. FAUNTLEROY

August 23, 1989

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