

FILED
SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

2004 JAN -7 P 4: 04

NEW YORK LIFE INSURANCE COMPANY, :
Petitioner

CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

Tax Docket No. 5235-92

v.

DISTRICT OF COLUMBIA,
Respondent

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial upon Petitioner's appeal from an assessment for real property taxes for tax year 1992. The parties filed Stipulations pursuant to Super. Ct. Tax R. 11. Upon consideration of the stipulations, the evidence adduced at trial, and having resolved all questions of credibility, the Court makes the following:

FINDINGS OF FACT

1. The subject property is owned by New York Life Insurance Company ("NYLIC"), a corporation organized and existing under the laws of New York. Petitioner NYLIC is obligated to pay all real estate taxes assessed against the subject property.

2. The subject property is located at 1333 H Street, N.W., Square 250, Lot 46, in the District of Columbia. It consists of

a 12 story high-rise office building built in 1913 and remodeled in 1982-1983 and an 11 story office building built in 1982. The buildings are located on the northeast corner of 14th and H Streets, N.W. A portion of the subject property the Landmark Building, is a historic structure which had to be rehabilitated and maintained in accordance with certain standards. The building has three levels of underground parking with spaces for 245 cars. The main building has 205,961 square feet of net rentable area. The Landmark portion of the building has a total of 34,618 square feet of net rentable area (32,395 for office and 2,223 for retail). These figures are derived from the lease rolls which reflect actual space, leased and vacant. The two buildings are accessible to each other only on the ground floor.

3. Leasing in the building has been poor. The Landmark Building has a small floor plate that makes it difficult to lease because it is less desirable. That space earns a lower rental rate.

4. The assessment for tax year 1992 as of January 1, 1991 was \$54,750,000. Petitioner timely appealed to the Board of Equalization and Review (BER). The BER reduced the assessment to \$42,770,766.

5. Petitioner timely paid the real estate taxes and timely filed the petition for a reduction of the assessment and refund of excess taxes paid for tax year 1992. In its amended petition, petitioner asserted that the fair market value of the property for tax year 1992 was \$39,000,000. This figure reflects the value set by its expert appraiser.

6. Larry Hovermale was the tax assessor for the subject property for tax year 1992. Mr. Hovermale was called as a witness by the petitioner and the respondent as well.

7. At trial, Mr. Hovermale testified that he assessed the property for tax year 1992 at \$54,750,000. He testified he used the mass appraisal approach, which encompasses the three recognized approaches to value, to arrive at his value for the subject property. He testified that he primarily relied on the income approach. The comparable sales approach was used as a check.

8. Mr. Hovermale testified that in calculating his gross economic income, he looked at leases signed at other properties to determine typical lease rates. He testified that he had the income and expense information submitted by the property owner and that he considered that information but did not use it. He estimated a market rent of \$26.00 per square foot. The

stabilized net income used by this witness in his calculation was \$4,790,638 versus \$4,500,811 used by the petitioner's appraiser. The difference between the two separate stabilized NOI calculations is \$289,827 or 6.4%. Although the parties disagreed as to the proper stabilized NOI to capitalize, the more substantial disagreement between them concerns the appropriate capitalization rate to be utilized to get the property's value based upon the income approach to market value, i.e., the assessor's capitalization rate of .0875 or the appraiser's capitalization rate of .11382.

9. With regard to his capitalization rate, Mr. Hovermale's testimony was not trustworthy. The assessor indicated that he obtained a range of capitalized rates from .0825 to .0950 selected from the Pertinent Data Book compiled by Standards and Review. He indicated that he selected the mid-point between the bottom and top figure, a statement which is factually incorrect because .0875 is not the mid-point between .0825 and .0950. Mr. Hovermale later testified that the Pertinent Data Book was not put together until after the valuation date of January 1, 1991. How the capitalized rate was derived by the assessor is at the very best ambiguous and at the worst factually incorrect and thus not worthy of credence either way. Additionally, in answering interrogatories propounded, Mr.

Hovermale stated that he used data from the Pertinent Data Book in deriving a capitalized rate. Mr. Hovermale testified that the assessment office prepared and published a schedule calculating a capitalization rate using the mortgage equity band of investment technique. This schedule included a substantial adjustment downward of the capitalization rate as a result of their assumption of a large appreciation in value in a declining or recessionary market. He admitted that he did not assume that the property would appreciate by 35% over seven years at the rate of 5% per year. Upon examination, Mr. Hovermale testified that the capitalization rate without the assumption of an appreciation in value was .1205. Mr. Hovermale testified that applying a capitalization rate of .1205 instead of his rate of .0875 resulted in a difference in assessment of approximately \$15,000,000 making a much higher assessment. Mr. Hovermale could give no justification for applying such a large appreciation factor to the subject property.

The assessor admitted that the published data of the American Council of Life Insurance (ACLI), included in the District's Pertinent Data Book, showed rates which were almost 3% higher than the assessor's rate.

Mr. Hovermale additionally claimed that the range of rates, including .0875, were derived from actual sales of improved properties and *pro forma* net operating incomes. Mr. Hovermale

testified that several of the sales used occurred before the real estate market entered a recession, yet no adjustments were made for this fact. The testimony in this case showed that the assessors methodology is totally unreliable in that the assessor could make the capitalization rate by his methods any number he wanted.

Mr. Hovermale also admitted that the capitalization rate he used was not high enough to take care of real estate taxes, the annual mortgage payments, and provide a fair return on the cash invested. In fact, a cash flow test showed that his capitalization rate would produce a negative return to the equity investment. The petitioner's expert recognized in her testimony that all buyers do not purchase commercial real property with the expectation that the purchaser will receive in exchange for the purchase price an asset producing enough income to pay real estate taxes, pay any mortgage secured by the real estate and provide a fair return on the cash invested but the typical (emphasis supplied) investor does. She indicated for example, that an atypical buyer may purchase commercial real estate mainly for price appreciation during the holding period, initially forgoing adequate income early on in exchange for asset appreciation later.

10. The foregoing facts show substantial flaws in the assessor's methodology for deriving a capitalization rate resulting in an erroneous assessment. As the assessment is invalid, the only remaining evidence before the Court was the testimony of Petitioner's expert Ms. Carol Mitten of the firm of Mitten & Reynolds.

11. Only the Petitioner offered expert testimony. Ms. Mitten appraised the subject property for the Petitioner. Ms. Mitten is a member of the Appraisal Institute and has the MAI designation. She has been qualified as an expert in the field of commercial real estate appraisal in various courts. The Court accepted her as an expert witness and received her tax year 1992 appraisal report in evidence. She testified to a market value of \$39,000,000 for the subject property as improved, including land and building, for the valuation date of January 1, 1991. The Court finds Ms. Mitten to be a credible witness and finds that her value accurately reflects "estimated market value" as defined by D.C. Code § 47-802(4) (1990 Repl.) Her testimony is supported by her appraisal report.

12. Ms. Mitten commenced her valuation of the property as improved by observing the real estate market. She testified that, as of the valuation date, the market was entering a real estate recession. Vacancy rates were increasing as newly

constructed buildings were delivered resulting in an over supply of office space. She also observed the neighborhood as of the valuation date. Ms. Mitten testified that while the Franklin Square area was improving, there was still a reluctance to move into the area.

13. Ms. Mitten then observed the condition of the property on the valuation date, January 1, 1991. She testified that the property was really two different buildings: the older Landmark Building built in 1913 and the new East Building built in 1982. The buildings are only connected on the lobby level. The Landmark building has a small floor plate. The entire property was 95% leased as of the valuation date.

14. For purposes of trial, Ms. Mitten accepted the assessor's land valuation of \$29,259,270.

15. In estimating the value of the whole property, Ms. Mitten considered all three approaches to value, including sales comparison, cost and income capitalization. She rejected for use in the appraisal for the subject property the replacement cost approach, which is appropriate for new or nearly new improvements. Ms. Mitten relied instead on the income capitalization approach because, she said, most potential buyers would use this method. To arrive at an indication of value by

the income approach, Ms. Mitten examined the income and expense history for the property for four years between 1987 and 1990. She also reviewed the rent rolls and leasing history for the building. Ms. Mitten testified that she used the actual rents received by Petitioner for the space actually leased. For the vacant space, she reviewed rental comparables and determined an economic rent of \$26.00 per square foot for the vacant space in the East Building and \$22.00 per square foot for the vacant space in the Landmark Building. Ms. Mitten added parking income of \$339,342 which excluded income from spaces in the vault space portion. She also added escalation income for existing tenants for CPI and operating expenses. Ms. Mitten subtracted \$272,885 in excess real estate tax pass-throughs. This resulted in a total potential gross income of \$6,411,625. From this figure, she subtracted a stabilized 7% vacancy and rent loss factor to arrive at an effective gross income of \$5,962,811.

16. Ms. Mitten stabilized expenses at \$6.08 per square foot, based on the operating expense history at the subject and typical operating expenses in comparable buildings. The subject's 1990 expenses were at \$5.80 and the range reported for the comparables was \$6.50 to \$8.25 per square foot, excluding real estate taxes. Ms. Mitten's net operating income was \$4,500,811. Ms. Mitten then applied her capitalization rate of

.11382 to the net operating income of \$4,500,811 to reach the valuation of \$39,543,235.

17. Ms. Mitten developed her capitalization rate using the financial band of investment technique. This is a traditional method of capitalization used when sufficient market data is available. Under this technique, the appraiser develops a weighted component of the mortgage and equity components to develop the overall rate. Ms. Mitten considered typical loan to value ratios, debt service, and equity dividend rates. She made a study of the market, including yield rates for comparable investments, surveys of rates conducted by the American Council of Life Insurance, the premier list of investment grade mortgage terms, and the opinions of the Appraisal Institute. All of the sources examined pointed to a capitalization rate of 9.2% to 9.3% for January 1, 1991 not including the tax rate. (The higher the capitalization rate, the lower the value.) The comparative risk and lack of liquidity of a real estate investment suggests the requirement of higher yield rates than treasury bonds. She applied factors based upon a 72% mortgage at 9.5% for 30 years for a constant of .101. She estimated the equity dividend rate at 7.0%. Her conclusion was .11382, including the tax rate.

Ms. Mitten testified that among other things, she took into account the Court of Appeals' view of an appropriate

capitalization rate as expressed in *Rock Creek Plaza- Woodner Ltd. v. District of Columbia*, 466 A.2d 857, 858 (D.C. 1983). "A number representing the percentage rate that taxpayers must recover annually to pay the mortgage, to obtain a fair return on taxpayers equity in the property and to pay real estate taxes." Ms. Mitten made clear that, except for the tax rate, which is fixed by law, all the other components in the formula she used to derive the capitalization rate were selected from the market.

The Court finds that the overall capitalization rate developed by Ms. Mitten is credible and strongly supported by the evidence and the range of factors that she considered. The Court therefore adopts for tax year 1992 the capitalization rate of .11382. The Court rejects the capitalization rate urged by the District of Columbia.

18. Ms. Mitten then deducted \$500,000 to correct problems in the basement. These problems included flooding and structural supports underpinning the sidewalks. After these deductions her final value rounded is \$39,000,000.

19. Ms. Mitten testified that she examined the market and determined a number of sales but concluded that she could not make use of the comparable sales method. She noted that beginning in 1990, the number of sales decreased significantly.

20. Ms. Mitten also commented upon the assessment performed by Mr. Hovermale. She testified that the assessor failed to account for the actual income and expenses at the subject property. As for the assessor's capitalization rate, she testified that the method used in which different rates were derived from the same sales was incorrect and flawed. Ms. Mitten also testified that Mr. Hovermale's capitalization rate did not provide a fair return on the equity after payment of the taxes and mortgage.

21. The Court finds that the stabilized income and expense estimated by the expert, Ms. Mitten, are more credible and based upon a thorough analysis of both historical and market data. As stated above, the Court also finds that the over-all capitalization rate developed by Ms. Mitten is credible and strongly supported by the evidence and the range of factors that she considered.

22. Accordingly, the Court, having adopted Ms. Mitten's testimony (unopposed by any other expert witness), finds that the market value and assessment for the tax year 1992 is \$39,000,000.

CONCLUSIONS OF LAW

This Court has jurisdiction over this appeal pursuant to D.C. Code §§ 47-825 and 47-3303 (1990 Repl.). The Superior Court's review of a tax assessment is de novo, therefore requiring competent evidence to prove the issues. See Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. 1980). Petitioner bears the burden of proving that the assessment appealed from is incorrect. See Safeway Stores, Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987). However, petitioner is not required to establish the correct value of the property. See Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986).

"The assessed value of property for real property taxation shall be the estimated market value of the property on January 1st of the year preceding the tax year." District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 112 (D.C. 1985) (citing D.C. Code § 47-820(a) (1990)). The estimated market value is defined as:

One Hundred 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 in a position to take advantage of the exigencies of the other.

D.C. Code § 47-802(4) (1990).

In determining estimated market value, factors that must be taken into account include: "any factor which might have a bearing on the market value of the real property including, but not limited to, sales information on similar types of real property, mortgage, ... income earning potential (if any), zoning, and government imposed restrictions." D.C. Code, § 47-820(a) (1990).

Petitioner has met the burden of proving the incorrectness of the assessment by showing that its own appraisal is more accurate than the District's assessment, not merely different. See YWCA v. District of Columbia, 731 A.2d 849, 852 (D.C. 1999). Also, there is sufficient competent evidence on the record for the Court to determine the fair market value of this property. When a taxpayer appeals an assessment to this Court, the Court can affirm, cancel, reduce or increase the assessment. D.C. Code § 47-3303 (1990 Repl.).

In Washington Sheraton Corp., the Court stated that "[w]hen an income-producing property has been in operation for a period of time, its past earnings assist the assessor in projecting future earning ability." Washington Sheraton Corp., 499 A.2d at 115. The Court also stated that the market value of an income-producing property includes the present value of the property's future income. See Id. Therefore, to arrive at a reliable

estimate for the stabilized net operating income of the property, the District must consider not only market conditions, but the experience of the property as well. Ms. Mitten did just that.

The capitalization rate used by the assessor in this case was allegedly provided to him by other members in his department. Its origin could not be determined from the evidence. There is no showing that it was derived from financial and economic information available in the market place. The reliance on calculating capitalization rates from sales and *pro forma* NOI is shown to be flawed. When the capitalization rate figure derived by the assessor was tested, it produced a substantial negative cash flow. This negative cash flow is strong evidence that the assessor's valuation does not reflect market value. A willing buyer would not buy the subject property at the assessor's value based on an assumed net operating income during 1991 when the property produced a negative cash flow while coupled with the commercial real estate investment climate being recessionary.

The Court must weigh all the evidence to determine which property valuation is the most credible. For the reasons already stated in the findings of fact, the Court rejects the assessed value and accepts the property valuation proposed by Ms. Mitten. Having considered the testimony and the appraisal report and

having rejected the tax assessment, the Court sets forth the reasons it accepts the only other evidence of valuation presented at trial.

The Court has generally recognized three approaches to value and it has been held that all three must be considered. See Washington Sheraton Corp., 499 A.2d at 113; Safeway Stores Inc. v. District of Columbia, 525 A.2d 207, 209 (D.C. 1987). The expert and the District's assessor examined all three approaches and both rejected the cost approach. Mr. Hovermale rejected the sales comparison approach while the expert relied on it to confirm her value by the capitalization of income approach.

Both the expert and the District's assessor gave considerable weight to the income capitalization approach. Of the three recognized approaches, the income capitalization approach is the preferred method for valuing income-producing properties. See 1015 15th Street. N.W.. Associates Limited Partnership v. District of Columbia, Tax Docket No. 3266-83 (Sup. Ct. November 13, 1984).

The Court examined the testimony and evidence and determined that the evidence supported Ms. Mitten's opinion as she considered both existing leases and market conditions and used a capitalization rate which among other things met the Rock Creek test. An expert's testimony may not arbitrarily be disregarded, disbelieved, or rejected. "When the trial Court

rejects the testimony of taxpayers' expert, there must be some basis in the record to support the conclusion "that the evidence of the taxpayers' witnesses is unworthy of belief." Rock Creek Plaza, 466 A.2d at 859. (citing Cullers v. Commissioner, 237 F.2d 611, 616 (8th Cir 1956)).

Therefore, based on the above conclusions, the Court finds that a preponderance of the evidence supports a figure of \$39,000,000 as the assessed value for the subject property as proposed by Ms. Mitten for tax year 1992.

In assessing real property, the value of the land and improvements must be identified separately. D.C. Code § 47-821 (a) (1990 Repl.). The parties did not contest the value that the District's assessor assigned to the land for tax year 1992.

Therefore, as stated previously, the Court adopts \$29,259,276 as the value of the land. The remaining portion of the assessment is allocated to the building. For tax year 1992, the Court finds that Ms. Mitten's value of \$39,000,000 is supported by the evidence.

It is therefore by the Court this 7th day of January, 2004

ORDERED, that the assessed value for the subject property is reduced and determined to be as follows for the tax year 1992:

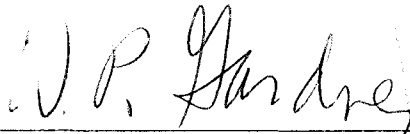
Land	\$29,259,276
Improvements	<u>9,740,724</u>
Total	\$39,000,000

It is further

ORDERED, that the assessment record card for the property maintained by the District shall be adjusted to reflect the value determined by this order.

It is further

ORDERED, that the parties or either of them shall submit a proposed judgment order or computation of over payment providing for a refund of the overpayment of taxes and interest due to the petitioner as allowed by law. A copy of the proposed order or computation pursuant to Superior Court Tax Rule 14 shall be served to each party and filed within thirty (30) days of entry of this Order.



JUDGE WENDELL P. GARDNER, JR.
Signed in chambers

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