SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

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SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

SQUARE 345 LIMITED PARTNERSHIP, Petitioner,	)	
v.	)	Tax Docket No. 7[illegible]9-97
DISTRICT OF COLUMBIA, Respondent.	)	

MEMORANDUM OPINION AND ORDER

This matter came before the Court for trial on Petitioner, Square 345 Limited Partnership's ("Petitioner" or "Square 345" or "taxpayer") appeal from an assessment for real property taxes for an office building known as 1001 G Street, N.W., Washington, D.C. ("Subject Property" or "Property"). The parties filed stipulations pursuant to Super. Ct. Tax R. 11(b). Upon consideration of the stipulations, the evidence adduced at trial, and having resolved all questions of credibility, the Court is convinced that the assessment is flawed in several respects, and it therefore cannot stand. Thus, the Court makes the following:

FINDINGS OF FACT

I. Background.

A. The Subject Property.

1. The Subject Property is owned by Square 345 Associates Limited Partnership, a limited partnership organized and existing under the laws of the District of Columbia and has a principal place of business at 1001 G Street, N.W., Suite 700 West, Washington, D.C. 20001. Petitioner is obligated to pay all real estate taxes assessed against the Subject Property.

2. The Subject Property is located at 1001 G Street, N.W., Square 345, Lot 41, in the District of Columbia. The land is a 39,551 square foot lot, and the site is improved with a two-part Class A office building containing 333,822 rentable square feet of above-grade office space, including 301,485 square feet in the West Building and 32,337 square feet in the East Building. The West Building is a twelve-story office building built in 1987-89, with five (5) levels of underground parking. The East Building is an historic building which is now comprised of the former nine-story McLachlen Building with new interior. The McLachlen Building was originally constructed in 1906. The exterior shell and floors were retained and a renovated 9 story building now occupies the site. The McLachlen Building has small floor plates of approximately 4,000 square feet. This is significant because the pool of potential tenants is limited to small users, thus the space is less competitive and commands lower rents. The two buildings are not connected except at the lobby level.

3. The Subject Property also includes 11,483 net rentable square feet of retail space, a 9,510 square foot health club (on two floors), 12,170 net rentable square feet of storage and 164,415 square feet of parking containing 302 standard parking spaces.

4. The Subject Property is zoned C-4 and developed to a 10 FAR.[1] The site is also located in the Downtown Development District Overlay Zone ("DD") and the DD Shopping District ("DD Shops") which was created, among other things, to encourage a concentrated area of retail, science, arts and entertainment uses in the Downtown area. As such, any new or altered buildings must designate at least 1.5 FAR of retail and arts if six stories or more were to be constructed. At the time of valuation, fifty-two percent (52%) of the 11,483 square feet of retail space was vacant. Thus, if the Property were to be developed at the time of valuation, it would be required to have 59,327 square feet designed for retail and arts uses, a significant amount of which would be unleased, especially given that, at the value date 5,971 sq. ft. of the retail space in the Subject Property remained unleased.

B. Assessment and Appeal.

5. As of the valuation date at issue in this case, January 1, 1996, all real property in the District of Columbia was reassessed every year. 9 DCMR § 305.1 (1998) The assessment for Tax Year 1997 for the property was as follows:

Land	$29,663,250
Improvements	<u>$46,312,750</u>

[1] FAR stands for floor area ratio, which is the relationship of the total gross building area above grade to the land area of the site. For example, if the land area and the building area are equal, the FAR would be 1.0.

Total	$75,976,000

For Tax Year 1997, all real property within the District of Columbia was divided into five classes for tax purposes. The Subject Property is in class four, which includes most commercial real property. The Tax Year 1997 tax rate for class four was $2.15 per $100 of assessed value. As such, the real property taxes for the 1997 Tax Year on the Subject Property were $1,633,484.

6. After receiving its assessment from the District of Columbia, the Petitioner timely filed an appeal to the Board of Real Property Assessments and Appeals ("BORPAA") on April 30, 1996. After an oral hearing, BORPAA notified Petitioner of its decision to sustain the assessment. The taxpayer timely paid the real estate taxes, and pursuant to D.C. Code § 47-3303, it timely filed a petition in the Tax Division of the Superior Court challenging the assessment of the Subject Property for Tax Year 1997.

7. In its amended Petition, Petitioner claimed that the valuation of the Subject Property for Tax Year 1997, as of January 1, 1996, was no more than $66,500,000, as set forth in its expert's appraisal report. If the Subject Property were valued at $66,500,000, then the total tax due would be $1,429,750 and a refund would be due Petitioner of $203,734.00 ($1,633,484.00 - $1,429,750.00 = $203,734.00), with interest from the date of filing suit.

8. The tax assessor for Tax Year 1997 was Quinton Harvell. Mr. Harvell is a commercial assessor with the Department of Finance and Revenue of the District of Columbia. Mr. Harvell was called as an adverse witness by the Petitioner. Mr. Harvell had not taken any courses given by the International

Association of Appraisal Officers ("IAAO") in the last ten years, and he had not taken any appraisal or assessment courses on the development or application of capitalization rates. Petitioner's other witnesses at trial included Donna Springs, a supervisory assessor. She also had not taken any courses related to appraisals or capitalization rates since the late 1980s. She testified that she was Mr. Harvell's supervisor as of the value date.

9. Petitioner's appraiser, Harry A. Horstman, III, MAI, was offered by Petitioner as an expert in commercial real estate appraisals, and Respondent stipulated to his qualifications. Mr. Horstman is a long time appraisal expert, teacher of appraisal courses at the American University, and a Member of the Appraisal Institute (MAI). He has over 10 years of experience in real estate and over 25 years of experience as an appraiser. He is a licensed appraiser in Maryland, Virginia and the District of Columbia. He has been active and has held many leadership roles in the Appraisal Institute, and the Maryland Appraisers Coalition. Mr. Horstman has performed many appraisals for many uses: for developers, lenders and for tax purposes. He has testified on many occasions as an expert appraiser regarding office and other commercial buildings. The Court accepted Mr. Horstman as an expert witness.

10. Mr. Horstman prepared an appraisal report for Tax Year 1997 which was admitted into evidence as Petitioner's Exhibit 14. He concluded that the Subject Property had an estimated market value of $66,500,000 for property as improved, including land and building, for the valuation date of January 1, 1996.

11. The Court finds Mr. Horstman to be a credible witness and accepts his conclusions as to the value of the Subject Property as well as his critique of the assessment. The Court further finds that his value accurately reflects the "estimated market value" of the Subject Property as defined by D.C. Code § 47-802(4) (Sept. 2000 Supp.).

12. The District called only one witness, Todd Zirkle, supervisor of Commercial Assessments for the District of Columbia. Mr. Zirkle valued the Property at a figure well above the assessment at issue, but the District continued to maintain that it had not abandoned its original assessment.

13. Respondent offered Mr. Zirkle as an expert in appraisal of real estate, over the objection of Petitioner. Although this Court accepted Mr. Zirkle as an expert, this Court finds that Mr. Horstman is more qualified and performed a more thorough analysis than did Mr. Zirkle. Mr. Zirkle's experience in appraising office buildings in the City while in private practice was limited to two to three appraisals. In contrast, Mr. Horstman has appraised hundreds of D.C. office buildings. Mr. Zirkle is not a licensed appraiser in the District nor does he hold the MAI designation. He has never been qualified as an expert prior to this case while Mr. Horstman has been qualified in dozens of cases. Mr. Zirkle has not taken any substantive appraisal courses in approximately five years while Mr. Horstman teaches courses on behalf of The Appraisal Institute.

14. Also, as Mr. Horstman noted, Mr. Zirkle failed to comply with the technical appraisal standards of the industry.

15. Mr. Zirkle stated in his report that he complied with USPAP[2]. However, as Mr. Horstman's stated, Mr. Zirkle failed to comply with "USPAP" for at least two reasons: (1) he failed to provide an accurate description of the type of report he prepared and include copies of the income expense forms and other materials referenced in his report; (2) he only summarized the historical data which misled the reader.

16. In addition, through cross examination, taxpayer's counsel revealed numerous report errors, lack of market data analysis and inconsistencies in his report and testimony. This Court gave more weight to the testimony and analysis offered by Mr. Horstman.

C. Market Conditions at the Value Date.

17. The market had crashed in late 1988 and still had not recovered from the ensuing recession at the time of valuation. As of the effective date of the assessment, January 1, 1996, the national as well as the local real estate markets continued to be soft. The nation and District of Columbia had been suffering through a recession although there were mixed signs of improvement. For instance, the East End absorbed 675,000 square feet in the first half of the year but gave back 404,000 square feet in the second half. See Petitioner's Exhibit 14, p. 10.

18. When the Subject Property was developed and the initial leases signed in 1989-1990, the real estate market was booming. Shortly after the building opened, the local and national real estate markets crashed. For the years

[2] The Uniform Standards of Professional Appraisal Practice ("USPAP") were developed to establish requirements for professional appraisal practice, which includes appraisal, appraisal review, and

following, there was little improvement to the area. Instead, there was an oversupply of office space in the District of Columbia, and competition was stiff among owners. Tenants had been enjoying better space at lower rents, with increased concessions from landlords, such as free rent and decreased pass-throughs, since 1989. Because the East End was an emerging market, it suffered greatly during that time. Furthermore, the Subject Property is located across the street from the old Woodward & Lothrop building, the former home of a local department store. One month prior to the valuation date, that department store closed. The impact of the closing on the neighborhood was significant.

19. Leasing activity had been declining during the 1990s, and at the value date, vacancy rates still indicated that commercial office space was in oversupply. In late 1995, there were negative absorption rates, and there continued to be a reduced demand for space.

20. Although 1995 had the first increase in absorption of space in six (6) years, the year produced a mix of positive and negative signs. The magnitude of the oversupply and the publicity of the District's financial problems did not suggest major improvement ahead to investors in the D.C. area. The D.C. Financial Responsibility and Management Assistance Authority (the "Control Board") had been appointed in 1995. The District's problems were exacerbated by the federal government laying off workers and generally requiring less space in the District due to its downsizing. Also, the area continued to suffer from private

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consulting. An appraiser should comply with the most current USPAP in effect at the time of the appraisal report.

sector, real estate funding problems, failures of banking institutions, the overbuilt office market from the 1980's. Petitioner's Exhibit 14, pp. 8-10.

21. The East End reported higher vacancy rates than the city average in the beginning of 1995 and 1996. Over 3 million square feet of office space and over 300,000 square feet of retail space was approved for development as of the effective date. Those approved projects, if started, would compete with the Subject Property.

22. Moreover, there were several approved but unbuilt projects in the neighborhood of the Subject Property. These projects had not been built because the developers could not sign tenants. Petitioner's Exhibit 14, pp. 10-13. However, they were positioned to proceed when the market rebounded.

II. Land Valuation of the Subject Property.

A. Land Assessment.

23. To assess the land, Mr. Harvell used the comparable sales approach. Land is always valued as if vacant and available for future development. Uniform Standards of Appraisal Practice (USPAP), Standard Rule 1-3(b) and other rules and The Appraisal of Real Estate at 324. See, also, 9E v. District of Columbia, Tax Docket Nos. 5240-92; 5783-93, Judge Cheryl Long, April 22, 1996. He looked at land sales of similar properties. He testified that there was a trend downward in the sales prior to the value date. He selected eight comparables as set forth in Petitioner's Exhibit 3. However, he made no adjustments whatsoever to his comparables in relation to the subject. That is, he did not adjust the prices to account for size of the site, date of sale, location, whether other items such as

additional FAR were purchased as part of the price, or whether the sale property was part of an assembly.

24. Mr. Harvell's selection of comparables was notable in that none of his sales were contained in the Pertinent Data Book listing of land sales. The Pertinent Data Book is a publication by the office of Tax and Revenue of data used by the assessors to make their assessments. Mr. Harvell's choice of sales calls into question the veracity of the information set forth in the Pertinent Data Book and the skill of the assessor. He did not know why his properties were not set forth therein, but it is indicative either that the City overlooked his sales or Mr. Harvell selected properties that should not have been used.

25. Mr. Harvell started with a rate of $50 per FAR. This rate was fairly well supported; the range of his eight sales was $46.00 to $86.35 excluding the 1992 sales. However, he then erroneously adjusted the $50 per FAR rate up for "assembly" and "corner" resulting in a rate of $75 per FAR. The assessor erroneously adjusted the Subject Property rather than the comparables which is not an acceptable methodology. Not only was the method unacceptable, the result was on the high end of the range of his own sales. As noted below, the taxpayer's expert, Mr. Horstman, properly adjusted the comparable sales to arrive at his conclusion of value for the land.

26. Mr. Harvell failed to account for the negative impact of the DD Shops overlay on the land value as the Property is located in the that zoning overlay district. The DD Shops overlay was implemented after the Subject was built but was in effect as of the value date. As noted above, land is valued as though vacant

and available for development. Thus, Mr. Harvell's failure to take into account the negative impact of the DD Shops overlay was, in this Court's view, a significant flaw in his analysis. Here again, Mr. Horstman properly factored into his land valuation the negative impact of the DD Shops.

B. Petitioner's Land Valuation.

27. As part of the appraisal process, the appraiser must examine the highest and best use of the site as if vacant and also as improved. This is important to ensure that one is valuing the land and improvements with consistency. The Appraisal of Real Estate at pp. 323-324. Mr. Horstman testified that if the site were vacant, any development would be required to comply with the DD Shops overlay. As noted above, at least 1.5 FAR of retail would have to be built, and fifty percent (50%) of the first floor would have to have retail or arts uses. Due to the poor market for land at that time, the crisis in the financial industry and these new Downtown Development requirements, Mr. Horstman concluded that the highest and best use as vacant was to hold the property for future development. That is, a developer would plan to build a commercial office building on the site in the future, but it would not build the office building on or immediately following the value date. See Petitioner's Exhibit 14, pp. 24-25. The District agreed with Mr. Horstman's conclusion. See Respondent's Exhibit 9, p. 26.

28. Mr. Horstman considered comparable sales and adjusted them for dissimilarities with the Subject Property. Mr. Horstman testified that the DD Shops overlay must be taken into account in valuing the land. This has a significant negative impact on value. As noted above, the Property as developed

contains 11,483 square feet of retail above grade. At 1.5 FAR, the developer would have to include 59,327 square feet of retail and arts uses but, because of the poor market, the vast majority of that space would be vacant. Petitioner's Exhibit 14, at pp. 26-27.

29. Mr. Horstman examined six sales that took place after the enactment of the DD Shops overlay but prior to the value date. He noted that there had been very few sales since 1989. Before adjustments, the sales ranged in price from $27.70 to $76.52 per square foot of FAR. After a series of adjustments for purchase or sale of Transferable Development Rights (TDR's), extraordinary construction costs, limitations on or approval of development plans, motivation of the parties, threat of condemnation, location and timing, Mr. Horstman concluded that three of the six were the most comparable: 9th & H Streets; 630-636 I Street; and 801 G Street. The first is considered the benchmark sale for the neighborhood. The site is superior to the Subject Property because it is not impacted by the DD Shops overlay. The second was a build-to-suit in Chinatown. The location and the Chinatown overlay zoning make it inferior to the Subject Property. The third it is also inferior to the Subject due to the Chinatown overlay and location. The purchaser also had to sell some of its additional TDR's due to the limitations of construction to FAR 6.0. Based on those sales, Mr. Horstman estimated a rate of $45.00 per FAR for the Subject or $417.18 per sq. ft. of land for a total of $16,500,000. This compares with the unreasonable and excessive assessment of $75 per FAR or $750 per sq. ft. of land. Mr. Zirkle valued the land by both the comparable sales approach and the land residual approach. In applying each

approach, he committed several errors. In the comparable sales approach, he failed to value the land as if vacant and available for development. While he recognized that the property was subject to the DD Shops overlay as of the value date, he not only stated the current terms of the overlay incorrectly but then refused to apply that overlay to the value of the land, insisting that it did not apply. He listed only three sales, all of which were out of date: one from 1992 and two from 1994.

C. Zirkle's Land Value.

30. Mr. Zirkle admitted that he made no adjustments to the sales in relation to the Subject. Moreover, Mr. Zirkle admitted that in his own appraisal of the Subject for the prior tax year, he had included more recent sales which were also at lower rates per square foot. Thus, his land valuation by the comparable sales approach was seriously flawed.

31. Mr. Zirkle also valued the land using the land residual technique. This approach was not applicable to the valuation assignment because he had previously determined that the highest and best use of the land as if vacant was to hold for future development. In addition, the figures he applied in the formulation were called into question.

32. This Court finds that only Mr. Horstman used accepted appraisal methodology to value the land and that his valuation is well supported. This Court accepts Mr. Horstman's land value of $16,500,000.

III. Value of Property as Improved.

33. There are three generally accepted approaches to the valuation of real estate. They are the comparable sales approach, cost approach and capitalization of

income approach. The applicable District of Columbia regulations describe each approach. See 9 DCMR § 307.

A. The Income Approach To Value

1. Assessment

34. Mr. Harvell testified that he relied entirely upon the income approach to valuing the Subject Property, as improved. He did not conduct a comparable sales approach or use a cost approach. In developing his assessment of the Property, he performed no real inspection of the Property except to simply walk by and look at the building from the road.

a. Assessor's NOI.

35. In developing his assessment using the capitalization of income method, Mr. Harvell estimated an economic net operating income (NOI) of $8,357,391. This compares with the actual net income for 1994 of $8,892,416. Calendar year 1994 data was the most recent year available to Mr. Harvell when he performed the assessment in the Fall of 1995.

36. Mr. Harvell identified his work sheet for the Subject Property, Petitioner's Exhibit 2, and he testified that the worksheet indicated that there was a trend downward regarding income on the Property.

37. Mr. Harvell admitted that he made no analysis of the market. That is, when asked whether he studied "any trends in the real estate market or of the valuation date when [he was] doing [his] assessment," he answered that he had not. This Court concludes that Mr. Harvell undertook no analysis of the market.

38. In preparing his assessment, Mr. Harvell consulted only the income and expense forms for the Subject Property, and the Pertinent Data Book prepared by the Standards and Review Section, excerpts of which were entered as Petitioner's Exhibit Numbers 7 and 11. He did not examine any comparable leases.

39. Mr. Harvell explained that he first estimated income and deducted estimated expenses to arrive at the net operating income. Then he applied a capitalization rate to convert the net operating income into a value.

40. In establishing the office income, he looked at the long term leases and the recently executed leases. First, he determined the amount of square feet of space subject to long term leases, those that will not expire within three years of the valuation date. For the Subject, this was 166,869 square feet. Then he determined the amount of space subject to short term leases and vacant space. This was virtually the same at 166,953 square feet. Next he determined the total annual income from the long term leases. Mr. Harvell testified that the rent averaged $40.45 per square foot for the long term office leases.

41. To determine market rent for the space under short term leases, Mr. Harvell identified six leases signed within the two prior years at the Subject Property. The median was $25.22 per square foot. This is the rent that the owner could be expected to receive for those leases expiring within three years after the value date and the space currently vacant. Thus, the rent for long term leases was $15.00 per square foot higher than what he determined market rents to be.

42. Mr. Harvell applied the market rent of $25.22 to the square footage under short term leases and the vacant space, 166,953 square feet. To this sum he

added the total annual income from the long term leases. Mr. Harvell then determined a "blended rate per square foot" of $32.84. This was simply an average of the rents. His calculation is set forth in his worksheet entitled "Blended Rate Calculation Worksheet Net Effective Rent Office and Retail" which was entered as Petitioner's Exhibit 6.

43. He testified that he used a blended rate of $32.84 per square foot for all of the office space. This figure was well outside the range of rates published in the District of Columbia's Pertinent Data Book for Tax Year 1997 for buildings in age category "G". The Subject is category "G" as buildings in that group were built between 1985 and 1993, he testified. The range of office rents was $19.14 - $26.62 per square foot for properties in this age category. This table of rates was provided to him by the Standards and Review Division of the Office of Tax and Revenue, and the relevant excerpt was entered as Petitioner's Exhibit 7. Mr. Harvell conducted a similar analysis for the retail space and concluded a rate of $37.90 per square foot.

44. After estimating the office and retail income, he estimated the income for parking and storage and added it to the rental income to determine the gross income for the Property.

45. He applied a vacancy rate of eight percent (8%), which figure was taken from the same Pertinent Data Book schedule for buildings in age category "G". See Petitioner's Exhibit 7.

46. In applying the expenses, Mr. Harvell did not evaluate the actual expenses at the Subject Property. Rather, he simply used a number from the Pertinent Data Book, which pages were introduced in Petitioner's Exhibit 7. He

used $8.50 per square foot of net rentable area. This figure was the "mid" range for expenses listed in this age category. This rate compared with the actual 1994 expenses at the Subject Property of $9.03 per square foot. In arriving at the expense rate, Mr. Harvell performed no other analysis of the expenses at the Subject Property and did not determine whether there were other expenses that should have been included. He did not include real estate taxes as an expense because, in an *ad valorem* valuation, one is solving for taxes. Thus, the tax rate is added to the capitalization rate. Likewise, he testified that real estate taxes should not be considered as income, but he did not make any investigation or determination as to whether any of the reported pass throughs included as real estate taxes and should be excluded.

47. It was clear from his testimony and the exhibits that Mr. Harvell recognized that approximately half of the office space was subject to long term leases at rents approximately $15 per square foot above market rents. However, he failed to make any adjustments in his valuation to account for the fact that the above market rents would not continue into perpetuity. When those spaces become available for leasing, the rents will be adjusted lower to current market conditions. As such, Mr. Harvell's estimate of economic income was flawed.

b. ~~Assessor's Capitalization Rates.~~

48. After deriving his economic net operating income, Mr. Harvell divided his NOI of $8,357,391.50 by a capitalization rate of .11 to obtain an estimated value of $75,976,000 rounded for Tax Year 1997.

49. Mr. Harvell testified that he did not calculate the capitalization rate on his own. Rather, he selected the figure from a range of rates set forth in the Pertinent Data Book. See Petitioner's Exhibit 11. The suggested range of overall capitalization rates was .1025-.1300. Mr. Harvell testified that he chose .11 based on the Subject Property's age, location, condition and income stream. However, he could not articulate why .11 was more appropriate than say .1150. In addition, he was only slightly familiar with the method used by his supervisor to derive the rates in the range.

50. Ms. Springs, Mr. Harvell's supervisor, testified that she was the author of the section in the District's Pertinent Data Book on capitalization rates. As noted above, the assessor, Mr. Harvell, simply selected a rate from the range of rates provided in the Pertinent Data Book. Ms. Springs testified that she used sales of other office buildings to develop capitalization rates. For each sale, she developed an NOI using the actual income for space under leases with more than three years remaining and market income for space due to expire within three years. The manufactured NOI's were then applied to the sales price of each property to yield a capitalization rate. Neither she nor any members of her staff asked parties to the sales in question what capitalization rate each buyer anticipated from the sale. Further, she could cite no publications or other sources consulted or investigation

undertaken to arrive at the recommended range of rates. Her method of establishing the capitalization rates was not in compliance with generally accepted methods.

2. **Petitioner's Income Approach.**

51. In establishing the net operating income of a property, an appraiser must first establish the net operating income of the property. As part of that inquiry, the appraiser must review the current market for similar office space to determine market rents. In undertaking this analysis, Mr. Horstman appropriately reviewed the recent leases signed at comparable buildings as well as recent leases signed at the Subject to determine market rents at the time. He identified five comparable leases for the West Building and three for the East Building. After making adjustments for concessions and other differences, the range of market office rates was \$23.17 – \$26.04 in the East Building and \$24.26 – \$31.97 in the West Building. For the East Building, Mr. Horstman concluded that the market rent was \$25.00 per square foot and for the West Building, \$30.00 per square foot. See Petitioner's Exhibit 14, p. 31.

52. After determining the applicable market rent, the appraiser must then evaluate the current leases at the subject and determine whether those leases are at, above or below market. He or she must examine whether the existing income, considering such items as excess rent (above-market rent) and other short term income, will continue into the future. Mr. Horstman compared the market rents to all of the leases in place at the Property. Mr. Horstman determined that there were several leases at above-market rents. Because these leases will generate above

market rents for a limited time, the time remaining in the terms of the leases, Mr. Horstman testified that this excess income cannot be included in the net operating income that is capitalized into value.

53. After undertaking the same analysis for the retail space, he concluded that the market retail rent was $30.00 per square foot.

54. Mr. Horstman added other income for the retail space, storage, parking, and miscellaneous income (such as after hours HVAC) to determine the gross potential income.

55. He then determined the vacancy and credit loss and deducted it from the gross potential rental income to arrive at the effective gross income of $10,158,500. From that sum he further deducted expenses for variable and fixed operation costs (payroll, security, supplies, insurance, licenses and vault rental), administration, utilities, maintenance and repairs. He estimated the expenses at $8.29 per square foot. Thus, he concluded that the net operating income of the Property was $7,294,500. This Court finds that income level to be conclusive in view of Mr. Horstman's analysis of the market and the Subject Property's history.

56. In completing the income approach to value, one must select a proper capitalization rate to convert the income to value. See Petitioner's Exhibit 14, p. 40; The Appraisal of Real Estate at 461-62. In selecting a capitalization rate, Mr. Horstman derived a rate using three different techniques. However, he placed the most weight on the rate derived from comparable sales; a preferred method when sufficient data exists. See Petitioner's Exhibit 14, p. 41-46; The Appraisal of Real Estate at 461-62. He examined five sales from the market.

57. Mr. Horstman also developed a capitalization rate using the mortgage equity band of investment. This method recognizes the influence of financing in acquiring an investment in real estate. He developed a weighted average of the mortgage and equity components to develop his overall rate of 9.64% plus the tax rate or 2.15% is 11.79%. Mr. Horstman also examined investor surveys and compared those rates to that derived from comparable sales as a check. He concluded that a rate of 11.35%, including the tax rate of 2.15% is appropriate. This Court concludes that his methods of determining the rate were accepted methods, and appropriate for this case. Applying the 11.35% rate to the estimated net income of $7,294,500 yields $64,300,000.

58. Because the Subject Property has above-market income, the valuation must be done in two steps. After the value is estimated with market rents, which Mr. Horstman concluded to be $64,300,000, the contributory value of the above-market rent must be added. That is, the income will not continue into the future indefinitely, but it does add some value to the property. Therefore, the value that it adds to the property must be calculated. Mr. Horstman concluded that the present value of the above market rents was $3,390,000. See Petitioner's Exhibit 14, pp. 46-47. Mr. Horstman examined each above-market lease to determine the rental income to be generated for the remainder of the term. He then compared those figures with the rent that would have been generated at market rates. The excess, or difference, was then discounted at 14.15% (including the tax rate) to the valuation date.

59. Mr. Horstman made final appropriate adjustments to value for tenant build-out, lost rent and real estate commissions that would be incurred in leasing the vacant space. After subtracting the present value of these deductions totaling $1,342,087, he arrived at a value estimate of $66,347,913; rounded to $66,500,000, as set forth in the table below:

Summary of the Petitioner's Income Approach

Income	
Market Rent	$10,203,000
Storage Income	$180,000
Parking Income	$500,000
Other Income	$40,000
Total Potential Income	$10,923,000
Less: Vacancy and Credit Loss (7%)	($764,500)
Effective Gross Income	$10,158,500
Less: Expenses	$2,864,000
Net Operating Income (NOI)	$7,294,500
NOI/.1135 =	$64,300,000
Adjustments	
Plus: Above Market Income	$3,390,000
Less: Cost of Tenant Build-out	($514,290)
Less: Lost Rent	($684,130)
Less: Real Estate Commissions	($143,667)
Value Estimate	$66,347,913
Rounded to	$66,500,000

3. Mr. Zirkle's Income Approach

60. In valuing the Property using the capitalization of income approach, Mr. Zirkle made a series of errors both in his estimation of income and in the development of his capitalization rate. With regard to his estimate of net income, he failed to complete an essential step: he never made a determination of market

rent for the office space. Because he never made a determination of market rent, he never got to the key issue in the valuation problem of the Subject Property: how to treat the above market rents at the Property.

61. Mr. Zirkle admitted in his testimony that he did not look at any leases either at the Subject or in comparable buildings and did not try to obtain them. He never even asked Petitioner for copies of leases at the Subject. He also admitted that he did not speak with any investors or parties to any transactions when preparing his report. In sum, he failed to make any attempt to secure actual market data that would indicate value.

62. To estimate the office rent, Mr. Zirkle compiled rental data pertaining to eight trophy office buildings. Virtually every "comparable" listed was superior to the Subject but he made no adjustments. Instead, he simply averaged all of the rent collected in each building without reference to the terms of the leases, concessions, location of the Property, condition of the Property or other factors affecting comparability to the Subject. He then simply averaged the average rents from each building to conclude a rate of $36.71. He completely failed to conduct any kind of analysis of the "comparable" leases.

63. Mr. Zirkle also made no distinction between the appropriate office rental rates for the East Building as opposed to the West Building despite the fact that he admitted that the McLachlen Building was a class B building. This Court notes that both the assessor and the City's Pertinent Data Book (and Mr. Horstman) list office market rental rates substantially below Mr. Zirkle's rate of $36.71 per square foot. The assessor said market was $25.22, the Pertinent Data

Book said $19.14 to $26.62 and Mr. Horstman said $25.00 for the East Building and $30.00 for the West Building.

64. In his estimate of the gross income, Mr. Zirkle included $1.4 million in escalation income. He testified that he did not know what was included in that figure however. Unlike Mr. Horstman, he made no analysis of the historical escalation income to determine if the full amount should be included in his estimate of gross income. As noted above, the historical escalation income included real estate tax pass throughs which must be excluded. By including real estate tax pass throughs but excluding taxes as an expense, the City is in effect taxing the owner on the taxes. Other pass throughs such as CPI adjustments must also be adjusted as these pass throughs would be reset to zero when new leases are signed.

65. This Court finds that Mr. Zirkle failed to properly analyze and estimate the net operating income of the Subject Property. This Court accepts Mr. Horstman's calculations as thoroughly considered and analyzed.

66. Mr. Zirkle then chose a capitalization rate of 10.65%. He testified that this rate was derived from comparable sales. However, he failed to analyze the sales properly and instead manufactured net operating incomes and applied those incomes to the sale prices. Like the assessor, he never spoke with parties to the transactions to determine what rates the buyers of those properties were anticipating when they purchased the sale properties. The rates from his sales ranged from 10.95%-12.55%; his own choice was below this range. Moreover, his rate of 10.65% was inconsistent with surveys that he admitted he consulted. The surveys indicated rates of 11.22% to 11.75% including the tax rate of 2.15%.

Finally, there were numerous errors in his calculation of a capitalization rate from the mortgage equity technique. This Court finds that Mr. Zirkle's capitalization rate is not well founded and is clearly below all other indications of the appropriate capitalization rate. This Court accepts Mr. Horstman's capitalization rate of 11.35% as thoroughly developed and analyzed and well supported by the market.

C. Cost Approach.

67. As noted above, there are three approaches to valuing real estate. Mr. Horstman considered the cost approach to value. However, he determined that this approach would not be useful in this case. First, there was little other new construction as of the value date and it would be very difficult to estimate cost without current cost comparables. Furthermore, because there was a significant shift in the market since the time that the Subject Property's improvements were built, it would also be very difficult to apply an accurate level of depreciation to arrive at a meaningful value. Last, Mr. Horstman had performed a full cost approach to value for the preceding Tax Year, and he found that the exercise was not useful to his ultimate conclusion. This Court accepts Mr. Horstman's testimony on the use of the cost approach.

68. Mr. Zirkle, in contrast, placed significant emphasis on the value by the cost approach. His testimony revealed several errors in addition to the fact that the approach was not applicable. First, he relied exclusively upon the Marshall & Swift publication of cost data without reference to actual costs for comparable properties. Then he used an economic life of 70 years; this was shown to be unreasonable in that no office building in the District of Columbia still in existence after 70 years

had not been renovated. In addition, he failed to properly estimate obsolescence and depreciation. Finally, his estimate by the cost approach reflected fee simple; he failed to make adjustments to reflect the above market rents at the property. As noted above, this Court accepts Mr. Horstman's treatment of the cost approach and thus places little weight on Mr. Zirkle's cost approach.

D. Sales Comparison Approach.

1. Petitioner's Sales Comparison Approach.

69. Both Mr. Horstman and Mr. Zirkle performed a sales comparison to determine the value of the Property as improved. In doing so, Mr. Horstman explained that there were very few building sales that were similar to the Subject Property. The sales that he identified needed to be analyzed and adjusted for differences in lease structure, location, and age as well as for dubious purchaser or seller motivation.

70. Both Mr. Horstman and Mr. Zirkle used many of the same sales. However, Mr. Horstman undertook a much more well-informed and thorough analysis. He examined six comparable sales and adjusted each for eight different factors relative to the subject including conditions of sale, market conditions, location, metro access, age & quality, size, economic profile, and condition. Mr. Horstman spoke with either the parties to each transaction or brokers involved to confirm the details of each sale. After adjustments, he arrayed the sales from net positive to net negative adjustments. The most similar were 2300 M Street and 370 L'Enfant Plaza with the first requiring a positive adjustment and the second requiring a small negative adjustment.

71. This Court concludes that Mr. Horstman's analysis and adjustment to the comparable sales is most convincing and is given greater weight than the analysis offered by the District's expert.

2. **Mr. Zirkle's Sales Comparison Approach.**

72. This Court concludes that Mr. Zirkle's sales comparison approach was flawed for several reasons. First, he placed too much emphasis on the sale of 901 E Street which was not a true arms length transaction. Second, he failed to make the proper adjustments to the comparable sales used.

73. Mr. Zirkle placed greatest weight on Comparable No. One, 901 E Street in the development of a value estimate by the sales comparison approach. However, that reliance is misplaced. The sale of 901 E Street, as explained by Mr. Horstman, was not an arms length transaction. Rather, the property was purchased by the government of Singapore who was trying to move money out of the Pacific Rim. That owner had unsuccessfully attempted to acquire two other buildings, and it may have paid more to simply have that the deal closed. Even on page 29 of his own report, Mr. Zirkle stated that one excludes sales by foreign governments:

> If an appraiser can identify sales comparisons, the sales must be investigated to be sure they are arms-length transactions at market prices. Non-arms-length transactions are eliminated. An appraiser should also delete transactions that are based on unusual investment values. For example, sales to foreign individual or entities that involve purchase decisions for particular individual reasons that are atypical of the prevailing local market.

Furthermore, he never verified the information regarding the sale until after his deposition. At trial he claimed that he had made calls, after his deposition, and claimed that no adjustment was necessary. This Court finds this testimony unsupportable and places more weight on Mr. Horstman's testimony that the sale is not indicative of the market.

74. In adjusting the comparable sales, which were identical to those used by Mr. Horstman, Mr. Zirkle improperly failed to adjust properties for location. For instance, Mr. Zirkle asserted that the 2300 M Street location was inferior to that of the Subject and needed to be adjusted up 15%. While an upward adjustment was appropriate, 15% was too much. In addition, Mr. Zirkle adjusted 1220 19th Street up 10% for location when in fact the location is equivalent to the Subject. The Court disagrees with that assertion based on Mr. Horstman's testimony, Mr. Zirkle's treatment of the Property in the preceding year and the court's own knowledge of the DC locations. In his report on the Property for the previous Tax Year, he adjusted it down 10% because of its superior location and building quality. See Petitioner's Exhibit 47. Also, he failed to adjust two sales that took place under the threat of condemnation that loomed over the transactions. Mr. Zirkle did not properly adjust the sales price of 370 L 'Enfant Plaza, SW. While he stated that it was the sale of the leasehold only, in fact, it also included the right to lease the land until 2012 at reduced rents. His 30% adjustment was excessive. As a result, this Court places less weight on Mr. Zirkle's analysis.

75. Weighing Mr. Harvell's testimony, Ms. Springs' testimony, the expert testimony of Mr. Horstman and the testimony of Mr. Zirkle, this Court finds that the assessment is invalid for several reasons. First, the Respondent's own expert valued the property at over $10 million above than the assessment. This alone was

sufficient for the Court to find the assessment invalid. Second, as noted above, Mr. Harvell failed to account for the Downtown Development District in valuing the land. Third, the assessor's estimate of net income was not supported by the history of the Property or the market. He failed to account for the effect of the above market rents and what would be expected to happen when those leases expired in the future. Finally, as noted above, the assessor's capitalization rate was not supported by the market. Moreover, Mr. Zirkle's methods for deriving the capitalization rate were flawed and are not generally accepted methods.

76. Having found that the assessment is invalid, this Court must examine the testimony of the two experts, Mr. Horstman and Mr. Zirkle. The Court is convinced that Mr. Horstman is more credible and performed a more thorough analysis of the market and the Subject Property.

CONCLUSIONS OF LAW

I. Standard Of Review And Burden Of Proof.

This Court has jurisdiction over this appeal pursuant to D.C. Code §§ 47-3303 (2000 Repl. Vol.). When a taxpayer appeals an assessment to this Court, the Court can affirm, cancel, reduce or increase the assessment. Id. As in all tax assessment appeals, this Court evaluates this case under de novo review. Square 345 Associates Ltd. Partners v. District of Columbia, 721 A. 2d 963 (D.C. 1998); Wyner v. District of Columbia, 411 A.2d 59, 60 (D.C. 1980). The Court's review is a two-step process. First, the Court must evaluate how did the assessor reached his or her estimate of market value and determine whether that conclusion is incorrect or flawed. Safeway Stores Inc. v. District of Columbia, 525 A.2d 207, 211 (D.C. 1987). In doing so, the Court must consider only competent evidence. The taxpayer bears the burden of proving that the assessments were incorrect or flawed. Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986).

If the Court determines that the assessment is incorrect or flawed, the trial proceeds to the second step in the process, evaluation of evidence as to the correct market value for the Subject Property. At that stage, however, the taxpayer does not carry the burden of establishing the correct value of its property. Id. However, if the District presents its own evidence of a value different than the assessment, it then bears the burden of proving that the new figure is correct. "Under Super. Ct. Tax R. 11(d), then, the burden of proof shifts to the District with respect to the new data it introduces to support an increase over the original assessment." Wolf v. District of Columbia, 597 A.2d 1303, 1312 (D.C. 1991) (Wolf I). The taxpayer may also present testimony as to a valuation and criticism of the District's evidence of a new value.

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 property valuation proposed by the District's assessor. The Petitioner, the taxpayer, in this case demonstrated that the assessor's conclusions were flawed and that he did not value the Subject Property in accordance with accepted methods of valuation. The Petitioner also established that the value of the Subject Property was substantially less than the value assigned by the District. Thus, Petitioner has met the required burden of proving that the assessment is flawed or incorrect and must be reduced. Brisker v. District of Columbia, 510 A.2d at 1039.

In addition, the Court concludes that there is sufficient competent evidence on the record for the Court to determine the fair market value of the Subject Property. The Court finds that Petitioner's expert, Mr. Harry A. Horstman, III, MAI, was more credible than Respondent's expert and Petitioner. His testimony should be given greater weight as to the value of the Subject Property for Tax Year 1997. Upon review of the testimony and documentation presented, the Court concludes that Petitioner's expert properly analyzed the market data and income data for the Subject Property, and he produced a logical and credible estimate of market value, $66,500,000.

II. Valuation of Real Estate.

The purpose of the tax assessment is to establish an estimate of value on which real estate taxes can be based. The D.C. Code provides that the assessed value of real property, for taxation purposes, shall be the "estimated market value" of the property on January 1st of the year preceding the Tax Year. D.C. Code § 47-820(a)(3) (2000 Repl. Vol.). Thus, the valuation date at issue in the instant appeal is January 1, 1996. "Estimated market value" is defined as:

> 100% 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 §47-802(4) (Sept. 2000 Supp.).

In other words, this Court must determine what would a buyer pay for the property as of the value date? In establishing that "estimated market value", the District shall take into account,

> all available information which may have a bearing on the market value of the real property, including, but not limited to, the following:
>
> (a) Government imposed restrictions;
> (b) Sales information for similar types of real property;
> (c) Mortgage or other financial considerations;
> (d) Replacement costs, less accrued depreciation because of age, condition, and other factors;
> (e) Income earning potential (if any);
> (f) Zoning;
> (g) The highest and best use to which the property can be put; and
> (h) The present use and condition of the property and its location.

9 DCMR § 307.1 (1998). All of these factors can be significant in valuing real estate.

There are three generally accepted approaches to the valuation of real estate. They are the comparable sales approach, cost approach and capitalization of income approach. The applicable regulations describe each approach. 9 DCMR § 307 (1998). Although the assessor must consider all three of these approaches, the assessor may, in the exercise of discretion, ultimately rely on one method in determining a property's market value. Safeway Stores, Inc. v. District of Columbia, 525 A.2d at 209; 9 DCMR § 307.2. The assessor, the District's offered expert and the taxpayer's expert all relied primarily upon the capitalization of income approach to value.

1. Market/Sales Comparison Approach. The "comparable sales" approach to valuation, also known as the "market" approach, attempts to determine value by studying the prices at which "reasonably comparable" properties have "recently" sold. Only arms'-length transactions are to be used. Quantitative and qualitative adjustments are typically made to the sales (not the Subject Property) to try to account for differences between the sale properties and the property being valued.

The sales comparison approach is applicable when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market. The Appraisal of Real Estate at 399. Buyers of income producing property such as office buildings usually concentrate on the sale property's economic characteristics. Thoroughly analyzing comparable sales of large income producing properties is difficult because information on the economic factors influencing buyers' decisions is not readily available. Id.

2. Cost Approach. The replacement cost approach attempts to value property based on the estimated cost to replace that property. First, the assessor or appraiser estimates the hard and soft costs to build a similar replacement, including at current costs for labor and materials. The estimated costs are then adjusted to take into account the amount of depreciation or loss of value attributable to the age and condition of the existing improvements, and any other pertinent factors which might have a bearing on value. This approach is useful in

valuing new or relatively new buildings. The Appraisal of Real Estate at 338. However, when improvements are older or do not represent the highest and best use of the land as though vacant, the appropriate costs and depreciation may be difficult to estimate because, "comparable data may be lacking or the data available may be too diverse to indicate an appropriate estimate of entrepreneurial profit". The Appraisal of Real Estate at 339.

> When value estimates derived with the cost approach are not supported by market data, they must be regarded with caution. Because the estimation of depreciation and entrepreneurial incentive (profit) is difficult, the cost approach may be of limited usefulness in valuing older improved properties.

Id.

3. Income Approach. The capitalization of income approach to value is based, "upon the amount that investors would be willing to pay to receive the income that the property could be expected to yield." 9 DCMR § 307.5 (1998). Stated another way, the approach attempts to measure the present value of the future benefits of property ownership. "A property's income streams and resale value upon reversion may be capitalized into a current lump-sum value." The Appraisal of Real Estate at 91. Thus, income divided by a capitalization rate equals value. Id. And, given the same income, a higher capitalization rate will yield a lower value. An overall capitalization rate "reflects the relationship between a single year's net operating income expectancy and the total property price or value; it is used to convert net operating income into an indication of overall property value". Id. at 456.

The income approach is usually considered the most appropriate method for valuing large income-producing properties, such as office buildings, hotels, apartments and shopping centers. The capitalization of income approach is the most favored method of valuing buildings like the Subject Property because it is most similar to the analysis used by knowledgeable buyers. Wolf v. District of Columbia, 611 A.2d 44, 47 (D.C. 1992) (Wolf II); District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 113 (D.C. 1985).

As with other valuation approaches, the income capitalization approach requires extensive market research. In undertaking a market analysis, one must consider supply and demand relationships which provide information about trends and market anticipation. The Appraisal of Real Estate at 92. The appraiser must ensure that its data is market-oriented and reflects the motivations of a typical investor in the marketplace.

A. Net Operating Income.

In estimating value using the income approach, the first step is to estimate a stabilized net operating income. Net operating income (NOI) is the gross income derived from the operation of the building less expenses. Real estate taxes are not included as an expense item in *ad valorem* valuations; the tax rate is added to the capitalization rate. The stabilized annual net income is derived by reference to the income and expenses of the property over a period of several years. Rock Creek Plaza-Woodner Ltd. Partnership, 466 A.2d at 858. Projected income less normalized expenses produce an NOI that reflects the market's anticipation of the future. In estimating the office/retail income, consideration of both the contract rent and market rent is required in determining the fair market value of the property. Wolf I, 597 A.2d at 1310. One should examine both market rental rates in comparable buildings and the actual rental income history for the Subject Property. Both items should be factored into the valuation calculations. The rents at the Subject Property may be at market, above-market or below-market. Actual earnings, of course, may be relevant evidence of a building's future,

> income earning potential, but it is the future potential, not the current earnings themselves, that must constitute the basis for valuation. . . . One reason, under the income method, for the focus on future income potential is that the actual income from the building may not reflect what a reasonable buyer would be willing to pay to receive the income that the property would be expected to yield. (citing 9 DCMR § 307.5 (1986)). For instance, if the income from the building is depressed because the owner entered into below-market leases that were not arm's length transactions, the income stream of the building owner would not necessarily reflect the total income-earning potential a willing buyer could expect from the building. (citing Folsom v. County of Spokane, 106 Wash.2d 760, 769, 725 P.2d 987, 992 (1986) (en banc)). . . . On the other hand, a purchaser would probably be unwilling to pay full market value for property encumbered by long-term below-market leases which the purchaser would be required to assume, unless the lease permitted the lessor to pass the tax burden on to the lessees. See id. 106 Wash.2d at 767, 725 P.2d at 991. The fact is
>
>> The amount of rental fixed by a lease, even though negotiated at arm's length, could be very misleading, as to true value of property, for it is well known that many rental contracts may be at excessive or inadequate rentals because of poor business judgment on the part of one party or another[, or because long-term contracts were] made in boom times or in times of depression . . .

Wolf, II, 597 A.2d at 1309-1310.

Expenses are determined in a manner similar to the income. Actual expenses at the Subject Property are compared with market expenses at comparable properties. Any discrepancies between the two should be investigated and explained.

C. Capitalization Rates.

Once the income and expenses have been estimated, it is necessary to choose an appropriate capitalization rate to convert the net income into value. There are several methods of establishing a capitalization rate. The D.C. Court of Appeals has stated, "the determination of an appropriate capitalization rate for a particular year for a particular property is a fact-specific determination not susceptible to a singular definition", and the determination must be based on a "generally accepted method." District of Columbia v. Rose Associates, 697 A. 2d 1236, 1238 (D.C. 1997). In the appraisal industry however, in order to make a sound determination, one must conduct a thorough review of the financial markets and the real estate markets. For instance, cash flow from real estate is measured against competing investments such as stocks and bonds, and the comparative risk and lack of liquidity of a real estate investment will suggest the rates. Since real estate is considered a long-term investment with greater risk and greater illiquidity than the bond type instruments, one would expect a significantly higher rate of return. These competing investments influence investor decisions and can dramatically affect property valuations.

Capitalization rates can be estimated with various techniques, depending upon the quality and quantity of data available. Accepted techniques include: 1) derivation of capitalization rates from comparable sales; 2) derivation from effective gross income multipliers and net income ratios; 3) band of investment – mortgage and equity components; 4) band of investment – land and building components; 5) debt coverage formula; and 6) yield capitalization techniques such as the Ellwood method. The Appraisal of Real Estate at 514.

The derivation of capitalization rates from comparable sales requires the consideration of sales of properties comparable to the subject. Thorough understanding of each sale is necessary. The mortgage equity band of investment is another common method to develop a capitalization rate. The band of investment technique is a traditional method of direct capitalization that recognizes the influence of financing in acquiring an investment in real estate. The appraiser develops a weighted average of the mortgage and equity components to develop the overall rate. The Appraisal of Real Estate at 517. In applying the band of investment technique, one considers typical loan to value ratios, debt service, equity dividend rates, and points paid in the mortgage process. All of these figures are derived from the marketplace. A third method is yield capitalization. "Yield capitalization is used to convert future benefits into present value by discounting each future benefit at an appropriate rate or by applying an overall rate that explicitly reflects the investment's income pattern, change in value, and yield rate." The Appraisal of Real Estate at 508. This type of capitalization rate focuses on yield anticipated by typical investors over a period of time, not just the first year.

D. Other Factors.

Other relevant factors which may also have a great impact on value. For instance, the state of the economy leading up to and around the time of valuation as well as the condition of the neighborhood surrounding the Subject Property are relevant factors. Also, any anticipated public or private improvements, located on or off the site, should be considered to the extent that market actions reflect such anticipated improvements as of the value date. USPAP, Standards Rule 1-4(f)(1999. For instance, a commercial building "is enhanced by attractive, spacious, accessible surroundings and damaged by unattractive, poorly maintained dirty surroundings." The Appraisal of Real Estate, p. 451 (11th Ed. 1996). Likewise, if demand for office space is low at the time of valuation and vacancies are up, the value of the Subject Property will likely be lower.

III. Conclusion

A. The Assessment.

In considering the three approaches to value, the assessor's evaluation must include a reflection of the market conditions as of the valuation date. In this case, the assessor, Mr. Harvell, determined market rent and then determined that many of the leases at the Subject Property were at above market rents. Proper application of appraisal principals thus required that the actual net income for the property be adjusted. The assessor properly determined that certain leases were at above-market rents, but he failed to adjust the valuation accordingly.

Assessor Harvell used a net operating income based upon the income and expense form and estimates of vacancy and expense figures that were provided to him through the Pertinent Data Book assembled by the District. Although he identified that there were above-market rents at the Property, he admitted that he did not give proper treatment to the upcoming expiration of the above market leases. The nature of these leases affects the ability of the Property to produce income in the future, but Mr. Harvell (and the City's offered expert) estimated a net income that could not be expected to continue into the future.

Mr. Harvell also erroneously included real estate tax pass throughs in his estimate of the income in his analysis. He thus overestimated the income of the Subject Property.

Because he did not take into consideration of these factors set forth above and gave no meaningful adjustment for the above market leases, he utilized an arbitrary and impractical method for determining a property's net operating income for purposes of valuation. By employing flawed and unaccepted methodologies in the projection of the net operating income that was not stabilized, his calculations were over-estimated and unreliable.

Assessor Harvell selected his capitalization rate in this case from a range that was provided to him by other members in his department. Aside from simply stating that he picked a rate in the middle of the range, he could provide no further explanation for his choice. Further, Ms. Springs testified that she computed the rates, however, she could provide little information or guidance to the Court as to how she performed that task. Because of the dearth of information underlying the District's development of capitalization rate applied in the assessment, this Court concludes that the rate derived was not supported by financial and economic information available in the market place (including data provided by Respondent).

In valuing the land, Mr. Harvell used the comparable sales approach. He erroneously made adjustments to the Subject Property (rather than the comparables) and failed to account for the Downtown Development District SHOPS District on the value.

All of the foregoing factors demonstrate that Petitioner has met its burden of showing that the assessment for Tax Year 1997 was erroneous and flawed. This Court concludes that the assessor did not base his value on "the amount that investors would be willing to pay to receive the income that the property could be expected to yield. . ." or what a willing buyer would pay for the property to a willing seller. 9 DCMR § 307.5 (1994). This Court concludes as a matter of law that the assessor did not correctly or properly estimate market value as required by the District of Columbia Code. Therefore, the Court concludes that the Court must determine a value for the Subject Property.

B. The New Value.

In this case, the Petitioner has not only shown that the assessment made by the District was flawed and erroneous, but it has also produced competent evidence of the actual value of its property by a well-qualified real estate appraiser. This case presents an instance, not uncommon to tax assessment appeals, in which there are two competing experts. As a result, the Court, in drawing its conclusions, must credit the testimony of one expert over that of the other. The law is clear that "[in] resolving factual issues presented by conflicting expert testimony, the trial court is in the best position to evaluate the experts' qualifications, demeanor, experience, reasoning, and testimony." Rock Creek Plaza, 466 A.2d at 859 (citing Designers of Georgetown v. E.C. Keys & Sons, 436 A.2d 1280, 1281 (D.C. 1981)).

In the instant case, there was a clear choice to be made and the better choice is to accept the opinion of Hal Horstman, based upon his extensive experience, his superior logic, his reliance on actual data to support his capitalization rate, and his realistic treatment of the above market rental income. His credibility and the weight of his testimony was also lessened due to his lack of experience in valuing commercial real estate, as well as the numerous errors brought to light in his report and his direct testimony.

In appraising the property, Mr. Horstman was concerned with the actual estimated market value. Real property taxes are required to be based upon the estimated value of the property as of January 1, of the year preceding the Tax Year. Estimated market value is defined in D.C. Code §47-802 (4). Mr. Horstman considered the full value of this property consistent with the statutory definition. The methodology and rationale of the Petitioner's expert are sound.

The Petitioner's expert, Mr. Horstman, used a more credible and reliable technique by first estimating a true stabilized net income and then making further adjustments to add in the present value of the remaining income to be received from the above market leases. The Court finds that the stabilized income and expenses estimated by Mr. Horstman are credible and based upon a thorough analysis of both historical and market data. Mr. Zirkle's net income was not in fact a stabilized income that could be expected to continue into the future. In fact, Mr. Zirkle never determined market rent. He over-estimated the net income by including above-market rents in his estimate of the net operating income and by including other income, such as real estate tax pass throughs which should have been properly excluded from the calculation.

The over-all capitalization rate developed by Mr. Horstman is credible and strongly supported by the evidence and the range of factors that he considered. Petitioner's expert developed his capitalization rate by reference to the actual market. Particularly persuasive to this Court is Mr. Horstman's use of actual market data. That is, not only did Mr. Horstman consult accepted industry publications in determining a capitalization rate, but also he consulted actual investors in the District of Columbia market to understand what rates investors were using as capitalization rates at the time of value. His capitalization rate of .1135 is accepted as being supported by the market. Mr. Zirkle's capitalization rate, on the other hand, was shown to be lower than the sources upon which he acknowledged to be the reliable market resources. Further, he failed to consult any investors or market players to gain insight into the market activity. Rather, he utilized a method of determining a capitalization rate which, as Mr. Horstman pointed out, no investors or appraisers utilize in the District of Columbia market.

The Court also finds that the comparables that Mr. Horstman used in his evaluation of the market and Subject Property were properly adjusted to account for the differences from the Subject Property and special circumstances of the properties in question. Mr. Zirkle's lack of investigation beyond the income and expense reports available to the District leads this Court to discount his testimony as to the comparables and generalities of the market.

Thus, the Court concludes that the method of deriving value from the capitalization of income method, as applied by Mr. Horstman, is a more reliable and a better indicator of value than the method applied by Mr. Zirkle. Accordingly, the Court having adopted Mr. Horstman's testimony, finds that the estimated market value and assessment for the Tax Year 1997, with a value date of January 1, 1996 is $66,500,000.

It is therefore by the Court this 25th day of March 2005,

ORDERED, ADJUDGED and DECREED as follows:

1. That the estimated value for the subject real property is determined to be as follows: $66,500,000.

2. That the assessment records for the property maintained by the District shall be adjusted to reflect the value determined by this Order.

3. That Respondent shall refund to Petitioner any excess taxes collected for Tax Year 1997 resulting from assessed value which are in excess of the value determining by this Order.

4. That entry of decision shall be withheld pending submission of a proposed Order under the provision of Super. Ct. Tax R.14.

Judge José M. López

CVT 7369-97

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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

SQUARE 345 ASSOCIATES

Tax Docket No. 7369-97

DISTRICT OF COLUMBIA

MEMORANDUM ORDER

This tax appeal is pending trial and is presently before the Court for adjudication of the Petitioner's Motion *in Limine* to Disqualify Respondent's Proposed Experts. This Motion is opposed by the District. The core of the Motion is an objection that the District's proposed expert witnesses are assessors whose testimony should be disallowed because they are not licensed in the District of Columbia. The Petitioner also contends that they should not be permitted to testify as experts simply because they are District employees. Finally, the taxpayer argues that they are inherently unreliable witnesses, because the alleged pressures of their employment with the District would ostensibly cause them to give biased testimony.

The two persons in question are James R. Vinson, the Chief Assessor and Todd D. Zirkle, also employed as an assessor. The District proposes to call either or both of them in defense of this tax appeal. Neither person participated in making the assessment that is the subject of this appeal.

The Chief Assessor was hired by the District of Columbia in 1999. He had served previously as a licensed appraiser in private industry. Vinson also has served as an assessor in other jurisdictions. In the trial of another tax appeal (*2020 K Street, L.P. v. District of Columbia*, Tax Docket Nos. 7250-96 and 7251-96), this Court (over the same objections) qualified him as an expert and permitted him to testify on behalf of the District of Columbia. Mr. Zirkle is employed under Mr. Vinson as a supervisory commercial assessor.

For the reasons that follow, this Court will deny the instant Motion. Each and every point raised by the District is well supported, both as to case law and concepts. For the sake of brevity, the Court will not repeat herein all of the legal citations and extensive arguments of the parties. The Court does, however, set forth below the essence of the arguments that are most convincing.

The License Issue: As a threshold matter, the Court concludes that neither person should be or will be precluded from testifying as an expert appraiser because they are both statutorily exempt from the obligation to obtain a license.

The Code provides that it is unlawful for any person in the District engage in the appraisal of real estate "without first obtaining a license or certificate as provided in this subchapter." D.C. Code §47-2853.153(a). However, the Code also provides, "Nothing in this subchapter shall abridge, infringe upon, or otherwise restrict the right to use the term 'certified assessor' or any similar term by any person certified by the Office of Tax and Revenue to perform ad valorem tax appraisal, provided that the term is not used in a manner that creates the impression of licensure or certification by the District to perform real estate appraisals other than for ad valorem tax purposes." D.C. Code §47-

2853.153(c) (1981). Thus, the Code exempts tax assessors from the requirement of obtaining a license.

The Petitioner seems to suggest that this provision applies only to rank and file assessors, who testify as fact witnesses in assessment appeals. They are typically called as adverse witnesses by Petitioners, because a Petitioner bears the burden of proving that the assessment is flawed or incorrect. Sustaining this burden is difficult to do, without establishing through the assessor's testimony how the assessment was actually prepared. Hearsay will not suffice. The individual assessor is not in the same posture as an expert, who purports to say whether the assessor correctly performed this function.

Secondly, the Court gives great weight to the obvious, underlying purpose for licensing requirements – and why this purpose is irrelevant to government assessors. The licensing requirement is part of a regulatory scheme that is directed towards consumer protection, *i.e.* to insure that those who hire or rely upon persons who claim this expertise are not defrauded. This is an analog to the licensure requirements for others who hire out their talent or art, such as physicians, dentists, and lawyers. Other examples abound. For instance, the Court of Appeals has recognized that one of the key purposes of the Real Estate Licensure Act of 1982 is "to provide increased protection to the public against incompetence, fraud, and deception . . . ." *RDP Development Corp. v. Schwartz*, 657 A.2d 301, 304 (D.C. 1995)(citation omitted).

Where tax assessors are concerned, the Executive Branch of the government is not a consumer or client – and needs no such protections. The same is true of the Judicial Branch of the government.

The Court is not a consumer who is relying upon the opinion in deciding whether to buy, sell, or finance property. Rather, the Court's relationship to the witness is totally different from that of a citizen who retains or relies upon what an appraiser does. Several factors reflect this distinction. For example, a court is a trier of fact who can choose whether to credit or discredit anything that the assessor has to say and, indeed, to substitute its own judgment as a matter of pure discretion. Seller, buyers, and lenders do not have this role or option at all.

Secondly, an assessor who is an expert witness (or lay witness) is subject to cross-examination and challenge by counsel or other experts. Those who purchase appraisal services, or who rely upon appraisals in the private sector, do not necessarily have the built-in luxury of such opportunities.

To boot, as with any witness, the Court also has contempt power over any assessor who testifies as an expert witness.

It should not be surprising, then, that the Code does not quibble about requiring assessors to obtain licenses before they can give testimony related to the assessment function. It is important to keep in mind that there is no statutory prohibition against assessors or any other government employees being called as expert witnesses.

Finally, the Court has examined the various points and authorities argued and cited by both parties. The most prominent case cited by the Petitioner is *Lee Gardens Arlington Ltd. Partnership v. Arlington County Bd.*, 463 S.E.2d 646 (Va. 1995). In essence, the taxpayer in that case successfully contended that a private sector appraiser who was not licensed should not be permitted to give expert testimony in an assessment appeal. As the District correctly points out, *Lee Gardens* is completely inapposite because the appraiser in question was not a government assessor at all. In Virginia, moreover, assessors are statutorily exempt from having to obtain a license. See VA CODE ANN. §54.1-2010(A.)(2.) (Michie 1950).

Two other factors support the denial of the instant motion as to this particular argument. First, the explicit exemption for government assessors is not the only feature of the licensure statute from which the Court can conclude that no license is required. The Court notices that the general licensure law commences with a definition of what persons are required to obtain licenses of any kind. This class of persons is defined as those who "engage in or carry on any business, trade, profession, or calling in the District of Columbia <u>for which a license fee or tax is imposed</u> by the terms of this chapter . . .. " D.C. Code §47-2801 (1981) [emphasis supplied].

On its face, the requirement for having to obtain any type of license is expressly dependent upon whether the person falls into a category of activity that is taxed or subject to a "fee."[1] Obviously, the District does not impose a tax or fee on the activity of its own assessment functions. The definition in Section 2801 yields the conclusion that licensure is wholly tied to protecting the public from those who operate in the public domain, not from within the government itself. For this reason, the exemption articulated in Subsection 2853.153 would seem to be superfluous.

Secondly, the context in which these proposed witnesses would be testifying is clearly activity that is embraced within the broad category of "ad valorem tax purposes." This phrase is certainly broader than the mere production of initial assessments. It

[1] There is scarcely any difference between a "tax" and a "fee" that is actually a toll payment for the privilege of being able to ply one's trade.

reasonably includes any effort directed to defending assessments and seeking additional taxes.

For example, this Court takes judicial notice of the fact that Vinson was called by the District as an expert witness in *2020 K Street* for the purpose of presenting a case for a greater valuation of the property, not for the purpose of defending the original assessments. In that context, an assessor whose appearance as an expert witness is designed to bring more tax revenue to the District (albeit by litigation) is certainly within the boundaries of the statutory exemption. The District's right to seek a higher assessment in a *de novo* proceeding in the Superior Court is nothing more than an extension of its authority to tax the subject property.

The Employment Issue: Here, the District makes a strong argument (despite foreign case law to the contrary) that there is no legal barrier to the use of a party's own employee as an expert witness. Many times, such witnesses have testified in the courts of the District of Columbia, and no appellate rulings have criticized such a practice as a matter of principle. No appellate ruling has resulted in reversal of a judgment, based upon this issue. In fact, the use of such witnesses has occurred countless times with this particular issue not even being the discrete grounds for the particular appeal. This is a phantom problem that has never been raised *sua sponte*.

The cases in which a party's own employee has testified as an expert witness include the following examples: *Wolf v. District of Columbia*, 597 A.2d 1303 (D.C. 1991) [a tax assessment appeal]; and *Eason v. United States*, 687 A.2d 922 (D.C. 1996) [Police Department officer as an expert in a criminal case]. Examples are endless, as the District observes, because medical examiners, DEA chemists, and many other such government employees routinely testify as government witnesses in criminal matters and other types of litigation.

At least one federal circuit court has squarely addressed this issue, observing, "That a witness is an employee of a party does not preclude his qualification as an expert . . .. His potential bias may be explored on cross-examination and argued to the jury." *Dunn v. Sears, Roebuck and Co.*, 639 F.2d 1171, 1174 (5th Cir. 1981

The Reliability Issue: Finally, the taxpayer urges the Court to preclude the proposed witnesses altogether for reasons of presumed bias. The whole matter of bias surely is a fair subject for cross-examination and goes to the evidentiary weight that should be accorded. This Court follows the premise articulated in *Dunn, supra.*

WHEREFORE, it is by the Court this 1st day of June, 2000

ORDERED that the Petitioner's Motion *in Limine* to Disqualify Respondent's Proposed Experts is denied. The Petitioner's objection as set forth in the Motion is preserved for any potential appeal.

CML

Cheryl M. Long
Judge

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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

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CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

SQUARE 345 LIMITED PARTNERSHIP,	:	
	:	
Petitioner	:	
	:	
v.	:	**Tax Docket No. 7369-97**
	:	
DISTRICT OF COLUMBIA,	:	
	:	
Respondent	:	

ORDER

Following a trial, this court entered its Findings of Fact and Conclusions of Law in the instant matter reducing the tax year 1997 assessment on the real property known as Lot 41 in Square 345. Pursuant to Superior Court Tax Rule 14, it is this 2 day of May, 2005

ORDERED that the 1997 real property tax assessment of Lot 41 in Square 345, known as 1001 G Street, NW, Washington, D.C., is $66,500,000, consisting of:

LAND	$29,663,250
IMPROVEMENTS	$36,836,750
TOTAL	$66,500,000

and the Office of Tax and Revenue's records shall reflect this valuation, and it is

FURTHER ORDERED that petitioner is entitled to a refund of real property taxes paid for tax year 1997 on Lot 41 in Square 345 of $203,734.00, with interest at the rate of six percent per year from September 26, 1997 until paid.

JUDGE

READ AND APPROVED:

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