

improvements. Petitioners appealed to the Board of Equalization and Review which reduced the assessment from \$52,013,000 to \$45,724,223. Petitioners timely paid the tax of \$983,070.79 and timely filed this appeal.

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

FINDINGS OF FACT

1. The subject property is located at 1301 E Street, N.W., Lot 835, Square 254 in the District of Columbia ("subject property").

2. Petitioner 1301 Associates, Vector Quadrangle II, General Partner, is a limited partnership organized and existing under the laws of the District of Columbia (hereinafter referred to as "Petitioner"). The principal office of Petitioner is 1001 G Street, N.W., Suite 700 West, Washington, D.C. 20001. Petitioner is the owner of the subject property, Lot 835 in Square 254 in the District of Columbia, improved by premises known as 1301 E Street, N.W.

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

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

5. Lot 835 in Square 254 has a land area of 27,410 square

feet. Its improvements are a mixed-use commercial structure of twelve stories with two below ground levels containing office, retail, parking and storage facilities with a net rentable area of approximately 220,000 square feet of which approximately 205,507 square feet is office use, 14,584 square feet retail space, 2626 square feet storage space and 68,347 square feet parking space. The subject site is currently zoned DD/C-5 PAD and is developed to a 9.2 FAR. The building has a major tenant, the National League of Cities, occupying approximately 45% of the office area with a 30-year lease which expires January 2011, with a five-year renewal option.

6. The petitioners have asserted that the fair market value as of January 1, 1989 of the property for tax year 1990 is \$31,140,000 and as of January 1, 1990 for tax year 1991 is \$31,000,000. The expert appraiser who testified in this case, so testified.

7. The assessor for the Department Finance and Revenue of the District of Columbia for tax years 1990 and 1991, used the mass appraisal technique and ultimately applied the income approach to value in assessing the property and determining the estimated market value.

8. Based on his opinion current market rates, the DFR's assessor determined the potential net operating income of the property to be \$4,860,065 for 1990 and \$4,421,082 for 1991. In contrast, the reported (actual) net operating income of the property was \$3,515,569, \$3,687,464, and \$3,737,317 for the years

1986, 1987 and 1988, respectively. The assessor gave these actual figures no weight in arriving at estimated market value, instead he used his own estimated income and subtracted his own estimated expenses. He then used these figures for the subject property to calculate the net operating income. This net operating income so determined was then divided by a capitalization rate of 9.83% in 1990 and 8.5% in 1991, and thereby he calculated the fair market value of the property to be \$49,441,000 for tax year 1990 and \$52,013,00 for tax year 1991.

9. In addition, the DFR assessor testified that he did not give any weight to actual income, actual expenses, lease-up costs, improvement costs, rent concessions or vacancy and collection losses.

10. The income on which DFR based its estimate of net operating income requires unrealistic assumptions. If for example, the property is purchased today, it would not be able to achieve the income which DFR projects, because the new owner would not be able immediately to rent 100% of the property at market rents. The new owner would have to wait for current leases to expire and then as the old leases expire sign new ones at market rents.

11. In this case, the rent for 45% of the office space is fixed, with increases for pass-through expenses and the like until, at least, 2011. The lease was for sound business purposes and entirely justified for a major lease, with a highly reliable and dependable tenant, running to the year 2011. It is, therefore, unreasonable to ignore the actual rent from this lease.

12. The Court finds that these errors by the DFR assessor resulted in erroneous estimated market values which caused the overassessment of the real property for the tax years in issue and, it is necessary for the Court to determine the estimated market value for the property and order any resulting reductions and refunds.

The Court finds that the proper method of obtaining net operating income for this property for the tax years in issue is to use actual income and actual operating expenses. The assessor's figures are rejected.

13. The assessments now before the Court are:

Tax year 1990:	\$39,256,531
Tax year 1991:	\$45,724.223

as reduced by the Board of Equalization and Review.

14. In addition to DFR's assessor, Mr. Harry Horstman testified as to estimated market value for the statutory dates. Mr. Horstman arrived at the land value by considering comparable sales and concluded that the respondent's assessed land value was correct for both years. The Court accepts the value of the land to be \$30,150,000 as set by the respondent's assessor, for both Tax years 1990 and 1991.

15. In calculating the value of the improved property, Mr. Horstman used the income approach and rejected both the market and cost approach; concluding that the highest and best use of the property was as developed.

16. Mr. Horstman calculated the actual net operating income of the property. The building has been virtually 100% leased (the

vacancy rate for calendar 1989 was actually 1.5%), and has had an average rent of \$21.13 per square foot, including pass-throughs and increases. The National League of Cities lease covering 45% of the rental space does not expire until 2011.

17. After subtracting estimated expenses, Mr. Horstman arrived at the net operating income of the subject property. He determined the net operating income to be \$3,519,097 for 1990 and \$3,597,720 for 1991.

18. The Court concludes that the actual net operating income for tax year 1990 should be the 1987 calendar net operating income of \$3,687,464 and for tax year 1991 it should be the 1988 calendar net operating income of \$3,737,317.

19. To arrive at the overall capitalization rate of the property, Mr. Horstman examined market conditions and economic indicators as well as other factors related to the property (e.g. lease terms, expense ratios, location). Mr. Horstman also considered bank rates and bond yield rates. Due to the greater risk and non-liquidity of real estate investments, petitioner's expert determined that the higher rates of Corporate Baa and A bonds provided the most relevant basis for risk as compared to other bank rates and bond yields.

	<u>Oct.</u>	<u>April</u>	<u>Oct.</u>	<u>April</u>
	<u>1989</u>	<u>1989</u>	<u>1988</u>	<u>1988</u>
Corporate Bonds Baa	9.91	10.61	10.41	10.90
Corporate Bonds A	9.44	10.20	10.01	10.17

20. Mr. Horstman also calculated a range of capitalization

rates using the band of investment technique, a traditional method of capitalization often used when sufficient market data is available. Under the band of investment technique, the appraiser develops a weighted component of the mortgage and equity component of 5% to develop the overall rate. In applying the band of investment technique, Mr. Horstman considered typical loan to value ratios, debt service, equity dividend rates, and points paid in the mortgage process. Using this formula, Mr. Horstman determined capitalization rates of .0927 for 1990 and .0933 for 1991.

21. Considering all of the above information and calculations along with factors affecting buyer motivation, Mr. Horstman decided on a formula for calculating the overall capitalization rate of the subject property: Mr. Horstman calculated the capitalization rate to be 9.27% before adding the real estate tax rate of 2.03% in 1990 and 9.33% before adding the real estate tax rate of 2.15% for 1991. Therefore, the capitalization rates were .1130 for 1990 and .1148 for 1991. The Court finds these to be the applicable rates for each respective tax year.

22. The Court finds that the two year overall capitalization rates developed by Mr. Horstman are credible and supported by the evidence and the range of factors considered by him, as well as the rate developed by the Band of Investment method. The Court, therefore, adopts for tax year 1990 the capitalization rate of .1130 and the capitalization rate of .1148 for tax year 1991. The Court rejects the capitalization rates urged by the respondent, because the DFR's assessor's assumption of the future rapid rise in

future rapid rise in appreciation is not justified by the evidence - most particularly the undisputed evidence that historic annual net operating income is stable rather than increasing.

23. Accordingly, the Court having found for tax year 1990 the 1987 calendar net operating income of \$3,687,464 and for tax year 1991 the 1988 calendar net operating income of \$3,737,317, the Court finds the estimated market value and assessments for the two years, as follows:

Tax Year 1990:

Net operating income \$3,687,464 divided by the capitalization rate of .1130 = \$32,632,424.

Tax Year 1991:

Net operating income \$3,737,317 divided by the capitalization rate of .1148 = \$32,555,026.

Conclusions of Law

1. 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. 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. 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. Brisker v. District of Columbia, 510 A.2d 1037, 1039 (D.C. 1986).

2. Petitioner has met the burden of proving the incorrectness

of the assessment. When a taxpayer appeals an assessment to this Court, the Court may affirm, cancel, reduce or increase the assessment. D.C. Code § 47-3303 (1990 Repl.).

3. In assessing this property for tax years 1990 and 1991, the respondent's assessor, used a net operating income based on his own estimated income and expense, but he admitted not giving weight to the actual income, actual expenses, current leases, and any lease-up costs of the subject property. These factors would obviously affect the ability of the property to achieve market rents today and in the future. Without consideration of these factors, utilizing his own estimate of new operating income and giving no weight to actual income and expenses is an arbitrary and unreasonable method for determining a property's net operating income for purposes of valuation.

4. In District of Columbia v. Washington Sheraton Corp., 499 A.2d 109, 115 (D.C. 1985), 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." The Court also stated that the market value of an income producing property includes the present value of the property's future income. Washington Sheraton Corp., supra, 449 A.2d 115. Therefore, to arrive at a reliable estimate for the net operating income of the property, the respondent must consider not only market conditions, but the experience of the property as well.

The respondent's assessor failed to take into account the property's actual income and actual experience. Failure to do so

resulted in a substantial increase in value as determined by the respondent. 1111 19th Street Association v. District of Columbia, Tax Docket No. 4082-88.

5. 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 assessor and elects the property valuation based on Mr. Horstman's capitalization rates and the actual net operating income for calendar year 1987 and 1988. Having considered the testimony and the appraisal reports, the Court has thereon set forth the reasons for selecting actual operating incomes and capitalizations rates computed by Mr. Horstman.

6. The reason for rejecting the higher net operating incomes selected by the DFR's assessor was the failure of the assessor to consider both existing leases and actual income as well as market conditions. A prospective informed buyer acting under no compulsion to purchase would consider both in estimating current and future income. The Court finds that the capitalization rates developed by Mr. Horstman are correct. Based on the above conclusions, the Court finds that a preponderance of the evidence supports an estimated market value for January 1, 1989 of \$32,632,424 for Tax Year 1990 and \$32,555,026 for January 1, 1990 for Tax Year 1991.

7. 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. Therefore, as stated previously, the Court adopts \$30,151,000 as the value of the land for both Tax Year 1990 and 1991. The remaining portion of the assessment is allocated to the building.

ORDER

Upon the findings of fact and conclusions of law made in the case above and upon the petitions filed herein, and upon the evidence adduced at trial, it is by the Court this 30th day of April, 1993, hereby,

1. ORDERED that the correct total assessment for the subject property for tax year 1990 is \$32,632,424 and that the correct assessment for the subject property for tax year 1991 is \$32,555,026; and it is

2. FURTHER ORDERED that the land assessment is \$30,150,000 for both tax years 1990 and 1991: and it is further

3. ORDERED that respondent be and hereby is, directed to modify the assessment record card to reflect the value of \$32,362,424 for tax year 1990 and of \$32,555,026 for tax year 1991 and for all subsequent years until a lawful reassessment has been performed; and it is

4. FURTHER ORDERED that the correct real estate tax on Lot 835 in Square 254 are as follows:

1990	\$662,438.20
1991	\$699,933.00

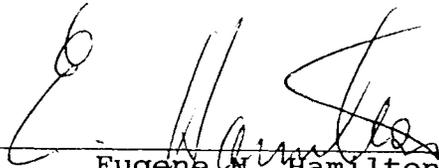
and it is

5. FURTHER ORDERED that respondent be and is hereby directed to refund to Petitioners, the following:

For, Tax Year 1990 real estate taxes in the amount of \$134,446.93 with interest from March 31, 1990 to the date of payment, at the rate of six (6) per cent per annum, the statutory rate, until paid; and

For, Tax Year 1991 real estate taxes in the amount of \$283,137.70, with interest from March 31, 1991 to the date of payment at the rate of six (6) per cent annum, the statutory rate, to the date of payment.

SO ORDERED.



Eugene N. Hamilton
Judge

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