
In The
Supreme Court of Virginia

RECORD NO. 091621

TB VENTURE, LLC,

Appellant,

v.

ARLINGTON COUNTY,

Appellee.

REPLY BRIEF OF APPELLANT

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES.....iii

INTRODUCTORY STATEMENT 1

ARGUMENT.....2

 I. THE COUNTY’S NEW POSITION, THAT APPELLANT IS NOT LEGALLY REQUIRED TO TREAT THE SUBJECT UNITS AS ENCUMBERED CBU LOW INCOME RENTAL HOUSING, IS NOT CREDIBLE 2

 II. BEGINNING WITH ITS COMPLAINT, APPELLANT HAS CONSISTENTLY ACKNOWLEDGED THAT IT IS BOUND BY THE CBU AGREEMENT AND THAT THE SUBJECT PARCELS ARE RESTRICTED BY THE TERMS OF THAT AGREEMENT 4

 III. THE APPROPRIATE MEASURE OF THE VALUE OF INCOME-PRODUCING REAL ESTATE IS THE DIRECT CAPITALIZATION OF ITS NET ECONOMIC INCOME..... 7

 IV. THE EVIDENCE BELOW CLEARLY REFLECTS THAT THE COUNTY COMMITTED MANIFEST ERROR IN THE ASSESSMENTS AT ISSUE 10

 A. Manifest Error May Be Shown by Either Implementation of an Inappropriate Methodology or by Disparity of Value 10

 B. Manifest Error with Respect to the 2007 Assessment..... 11

 C. Manifest Error with Respect to the 2008 Assessments 13

V. THE RAILROAD CASES DO NOT ALTER THE REQUIREMENT THAT THE ASSESSOR MUST CONSIDER CONTRACT (ACTUAL) RENT 13

VI. THE ASSIGNMENTS OF ERROR REFLECT THE COURT’S RULINGS..... 15

CONCLUSION 15

CERTIFICATE..... 17

TABLE OF AUTHORITIES

Page(s)

CASES

Arlington County Board v. Ginsberg,
228 Va. 633, 325 S.E.2d 348 (1985) 8, 9

Bd. of Supervisors of Fairfax County v. Donatelli & Klein,
228 Va. 620, 325 S.E.2d 342 (1985) 8, 9

Clarke Assoc. v. Arlington County,
235 Va. 624, 369 S.E.2d 414 (1988) 8, 15

Richmond, Fredericksburg and Potomac RR Co. v. Commonwealth,
203 Va. 294, 124 S.E.2d 206 (1962) 13-14

Richmond, Fredericksburg and Potomac RR Co. v. State Corporation Commission,
219 Va. 301, 247 S.E.2d 408 (1978) 14

Seaone v. Fairfax County Bd. of Supervisors,
35 Va. Cir. 351-365 (Fx. Cir. 1995)..... 7-8

Smith v. Bd. of Supervisors of Fairfax County,
234 Va. 250, 361 S.E.2d 351 (1987) 12

West Creek Assoc. v. County of Goochland,
276 Va. 393, 665 S.E.2d 834 (2008) 10

STATUTES

Va. Code § 15.2-735.1 6

Va. Code § 15.2-2283..... 6

TO THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE
VIRGINIA SUPREME COURT:

INTRODUCTORY STATEMENT

Appellant TB Venture, LLC, (“TB Venture”) respectfully submits this
reply to Arlington County’s Brief of Appellee:

This appeal centers on two straightforward precepts: (1) when
assessing the value of low-income rental housing, the Assessor must take
into account the rent restrictions imposed on the owner by the low-income
housing program, especially where those restrictions are established in
fulfillment of site plan approval conditions, specified in a written agreement,
and memorialized in recorded covenants; and (2) the Assessor must give
great weight to a contemporaneous arms length sale of that low-income
rental housing.

Rather than simply address those issues, the County’s Brief is largely
a personal attack on the Appellant and its witnesses meant to divert the
Court’s attention from the case’s underlying merits and legal foundations
upon which they rest. In pressing that attack, the County misstates the

Appellant's positions, and fails to address or accurately discuss critical issues and controlling authority.¹

ARGUMENT

I. THE COUNTY'S NEW POSITION, THAT APPELLANT IS NOT LEGALLY REQUIRED TO TREAT THE SUBJECT UNITS AS ENCUMBERED CBU LOW-INCOME RENTAL HOUSING, IS NOT CREDIBLE.

For the first time in this case, the County now asserts that neither TB Venture nor its 21 units at the Odyssey complex are subject to the low-income rental housing restrictions on which the approval of Site Plan No. 350 was conditioned, nor the related Community Benefit Housing Program Agreement ("CBU Agreement") (JA at 289, *et seq.*), nor the recorded Declaration of Covenants. JA at 312, *et seq.* According to the County, "There is no dispute that TB Venture has itself chosen thus far to treat these particular units as community benefit units, *although it is not legally required to do so.*" Appellee's Brief at 9 (emphasis added). The County's new contention is untenable. It would render the Site Plan Approval, the CBU Agreement, and the recorded Covenants nullities. It ignores the legal

¹ While the County does not challenge Appellant's summary of the standard of review for granting a Motion to Strike, nowhere in its Brief it does it view the evidence and the inferences in the light most favorable to Appellant. Appellant's Brief at 30-31.

constraints burdening these properties and TB Venture's purchase of them subject to those burdens.²

At the same time, if the County is sincere that this is the considered position of Arlington County, it could provide TB Venture with a binding agreement releasing it and the 21 subject units from any low-income/affordable housing obligations under Site Plan No. 350, the CBU Agreement, and the Declaration of Covenants, while holding it harmless from any claims asserting any ongoing duty under the low-income rental housing restrictions relating to the Odyssey Development. Such an agreement would certainly dispose of this case.

The residential portion of the Odyssey development consisted of 274 units, of which TB Venture's predecessor-in-interest designated the subject

² At trial, the County never contested TB Venture's obligations to maintain 21 units as the CBUs contemplated in the Site Plan approval and required in the CBU Agreement. In addition to introducing into evidence, without objection from the County, the CBU Agreement (JA 289, et seq.), the Declaration of Covenants (JA 312, et seq.), the January 7, 2005 letter from MR Odyssey specifically identifying the subject units as the 21 units that had been "designated as community benefit units" (JA at 280-281), and the County's "Department of Real Estate Assessment Property Information" records that identified each of these units as "Property Class: 642-Community Benefit Unit," (JA 372-415) TB Venture called as a trial witness Thomas L. Rice, the County's Director of the Department of Real Estate Assessments, the County Real Estate Assessor and the County's representative at trial (JA at 199). Mr. Rice testified that he was familiar with the subject units, that they are Community Benefit Units, restricted to eligible tenants, restricted in the rent that can be charged, and are subject to those restrictions for 40 years. JA at 200.

21 units as the required CBUs. JA at 280. *Compare* JA at 281 with JA at 30. The units were offered for sale as restricted low-income rental units, (JA at 280) and TB Venture purchased them in good faith subject to those restrictions. The County Tax Assessor's records classified the units at issue as community benefit units, (JA at 371-415); the Virginia Housing Authority extended financing on these units as restricted low-income units, (JA at 232) and they are subject to the County's audits and compliance standards. CBU Agreement, JA at 292, ¶ 4 (County Right of Inspection), 292-293, ¶ 5 (Administration of CBUs). The other units in the building were sold as condominium units to the public at large, unrestricted by any affordable housing program constraints.

II. BEGINNING WITH ITS COMPLAINT, APPELLANT HAS CONSISTENTLY ACKNOWLEDGED THAT IT IS BOUND BY THE CBU AGREEMENT AND THAT THE SUBJECT PARCELS ARE RESTRICTED BY THE TERMS OF THAT AGREEMENT.

The County makes the surprising allegation, "TB Venture *argues or implies, for the first time in this case* in this appeal, that the restrictions it claims encumbers [sic] the Subject Properties were not voluntarily entered into by the developer but were imposed by the County." Appellee's Brief at 23 (emphasis added), *See also id.* at 2. In support of this assertion, the County cites to six specific references in Appellant's Brief. Appellee's Brief at 23. Not only are the statements, themselves, absolutely accurate, but

the allegation that TB Venture changed its position utterly ignores the trial court's record. For instance, the first two citations reflected that the restrictions were a condition to the site plan approval. *Id.* From the inception of the case, TB Venture has recognized that the conditional Site Plan Approval, the CBU Agreement, and the Memorandum of Covenants constitute legal obligations and binding constraints. While 15th and Scott Street agreed to these conditions during the site plan approval process, once it signed off on the agreement and memorandum, their terms became mandatory and enforceable.

Contrary to the County's allegation, TB Venture consistently maintained that these restrictions are binding. In its Complaint, TB Venture alleged in Paragraph 1, "That Site Plan specifically requires, *inter alia*, that the then owner of the property implement an Affordable Housing Plan in accordance with the terms of the [CBU] Agreement." JA at 2. At the Motion to Strike, TB Venture pointed out, "There is no doubt that the site plan, the contract between the County and the developer and the memorandum sprayed on the – on the land records, restrict the ability to sell these units as condominiums." JA at 258. Again at the Motion to Strike, TB Venture also relied on the language in the Declaration which gave the County the

power to sue it if TB Venture did not provide the units or abide by the developer's obligations under the CBU Agreement. JA at 260-261.

The third citation to which the County points is on pages 41-42 of Appellant's Brief: "However, the County's position ignores the fact that low-income affordable rental housing restrictions like those at issue are imposed to further the public policy of the Commonwealth of Virginia." TB Venture is referring to "restrictions like those at issue" and then cites to Va. Code Sections 15.2-2283 and 15.2-735.1, which declare among the purposes of zoning ordinances, is to further the provision of affordable housing and that to accomplish this, the County is authorized to condition the approval of certain zoning special exceptions on the provision of affordable housing.

The County's final three citations all address the County's position that the legally enforceable restrictions should be disregarded because they are "artificial" and "voluntary." Again, for the reasons set forth in Appellant's Brief at 43-48, these restrictions are real and enforceable. However, what is more troubling is the specious assertion that TB Venture argued one thing before this Court and another thing before the trial court. It is absolutely beyond doubt that TB Venture argued below that the conditional site plan approval, the CBU Agreement, and the recorded

covenants required TB Venture to rent these units to qualified tenants at reduced rents for the next 40 years. Indeed, the County objected during TB Venture's argument on the County's Motion to Strike on the very issue that these restrictions are legally enforceable, and that the memorandum specifically authorizes the County to file suit to enforce them in the event that TB Venture decided that these restrictions are voluntary and to no longer comply. JA at 260-261.

III. THE APPROPRIATE MEASURE OF THE VALUE OF INCOME-PRODUCING REAL ESTATE IS THE DIRECT CAPITALIZATION OF ITS NET ECONOMIC INCOME.

Ignoring binding precedent, the County has insisted throughout this case that the net income capitalization method fails to value the fee simple interest in these low-income housing units. The County goes to great lengths to disparage Mr. Shields and the Appellant's position by repeatedly claiming that the leased fee is only a partial interest. Under this theory, a lease divides the fee simple estate into landlord's leased fee and the leasehold interest belonging to the tenant. Accordingly, the County argues, the tenant is the beneficiary of the difference between unrestricted rent and restricted rent, and that the value of that difference must be assessed. Appellee's Brief at 11-12, 26-27. The only case the County cites in support of its position is *Seaone v. Fairfax County Bd. of Supervisors*, 35 Va. Cir.

351-365 (Fx. Cir. 1995). In so doing, it ignores the fact that twenty-two years ago Arlington County made the same argument before this very Court:

In an attempt to justify the County's assessment at a higher rate, the County attorney says that when contract rents are below economic rents, the landlord, in effect, has made the tenant his partner. Therefore, the landlord no longer owns a full fee simple interest and, if the assessment does not include the tenant's "leasehold interest," the full fee simple interest would not be taxed.

Clarke Assoc. v. County of Arlington, 235 Va. 624, 628, 369 S.E.2d 414, 416 (1988). This Court clearly and unequivocally rejected that argument, noting that it previously had determined that an assessment based on contract rents which are less than that which County asserts are the economic rents, does not violate the constitutional mandate to assess the full market value of the fee simple interest. *Clarke Assoc.*, 235 Va. at 628, 369 S.E.2d at 416 (citing *Bd. of Supervisors of Fairfax County v. Donatelli & Klein*, 228 Va. 620, 631, 325 S.E.2d 342, 348 (1985)).

The County attempts to distinguish both *Donatelli & Klein* and *Arlington County Board v. Ginsberg*, 228 Va. 633, 325 S.E.2d 348 (1985), by asserting that these cases dealt with fee simple interest and not the leased fee. Appellee's Brief at 28, 41-42. The distinction the County attempts to draw is, at best, misleading. *Donatelli & Klein* also rejected the

concept that the difference between actual rent and what the County claims is the unrestricted fair market rent constitutes a taxable leasehold interest. “However, the economic rent approach employed by the County, disregarding actual leases, was based on a theoretical return obtainable under optimum conditions which may never exist.” *Donatelli and Klein*, 228 Va. at 631, 325 S.E.2d at 347. In the instant case, any theoretical return in excess of the restrictive rents would not be obtainable until the 40 year restriction term expires. See Appellant’s Brief at 36-40.

Contrary to the County’s description of *Ginsberg*, this Court found that the fee simple does not include any value of the reversion after expiration of the leasehold interest and that, “as a general rule, determination of fair market value by capitalization of economic rents is the preferred method, a consideration of contract rent is required in ascertaining economic rents. Where there has been a recent sale of the property, of course, such sale should be considered.” *Ginsberg*, 228 Va. at 640, 325 S.E.2d at 352 (citations omitted).

IV. THE EVIDENCE BELOW CLEARLY REFLECTS THAT THE COUNTY COMMITTED MANIFEST ERROR IN THE ASSESSMENTS AT ISSUE.

A. Manifest Error May Be Shown by Either Implementation of an Inappropriate Methodology or by Disparity of Value.

The County devotes five pages of its Brief discussing the general principles of establishing manifest error and challenges to the assessment of real estate. In so doing, the County proffers its own standard for establishing manifest error:

Thus, the Plaintiff's evidence must establish an *unmistakable, indisputable* error of commission or a *complete error of omission clearly evident at the time of the assessment* and materially affecting the underlying valuation.

Appellee's Brief at 40 (emphasis added). Strikingly, nowhere in its Brief does the County acknowledge or even refer to this Court's most recent discussion of this issue. Instead, the County postulates a manifest error test far more stringent than anything this Court has imposed. *West Creek Assoc. v. County of Goochland*, 276 Va. 393, 409-411, 665 S.E.2d 834, 843 (2008) (surveying methodology cases); see *also* Appellants Brief at 32-33.

In *West Creek Assoc.*, this Court held that the taxpayer may show manifest error either by demonstrating that the methodology employed by the taxing authority was erroneous (including disregarding controlling

evidence) or by establishing that the assessed value falls outside the range of a reasonable difference of opinion of the property's fair market value. *Id.*

B. Manifest Error with Respect to the 2007 Assessment.

The County asserts, "TB Venture's sole complaint is that the BOE applied a Countywide expense ratio in determining the net operating income of the subject properties as a whole, rather than the specific expenses for the Subject Properties." Appellee's Brief at 42 (*citing* Appellant's Brief at 49). The County completely ignores TB Venture's argument that the 2007 assessment, as adjusted by the BOE, of \$3,698,100, fell outside the range of a reasonable difference of opinion of value, thereby, independently establishing manifest error. Appellant's Brief at 32-33. While the County cited authority that a mere difference of opinion as to value is insufficient to establish manifest error, (Appellee's Brief at 40-41) it never addressed TB Venture's assertion that the 2007 (and 2008) assessments so far exceeded the range of a reasonable difference of opinion to constitute manifest error. Appellant's Brief at 33.

The BOE had before it expenses related to the subject units for the year 2007. Most of the information consisted of actual known amounts, such as the condominium association dues. Some were TB Venture's projections based upon Paradigm's experience in the management and

rental of apartments, including low-income housing. Paradigm managed approximately 9,000 rental housing units of which 2,000 were low-income housing. Appellant's Brief at 11; JA at 39. Given this vast experience, including management of a high-rise apartment building directly across the street from the Odyssey, Paradigm's ability to budget expenses incurred in managing a portfolio of apartments is not comparable to estimating lost profits from a brand-new business. Appellee's Brief at 43, n. 29. While this may have been a new building, it was not a new business to Paradigm. Rather than apply expenses relating to these units, or even a dollar amount benchmark for units such as these, the BOE applied an expense ratio derived from rental apartments throughout the County in high-rise buildings regardless of whether the rent was restricted or not. The use of a countywide expense ratio such as this, particularly where applied to restricted income units, constitutes manifest error. *Smith v. Bd. of Supervisors of Fairfax County*, 234 Va. 250, 257, 361 S.E.2d 351, 355 (1987).

This error becomes more manifest after reducing the expense ratio to a Dollar figure. As described in the Appellant's Brief, the BOE did apply the actual income as reported on the TB Venture's 2007 Summary of Operating Analysis. JA at 367. That total income equaled \$316,980. The

County expense ratio equaled 25% of the income, or \$79,245. Yet, one of the known expenses was the condominium association dues. The 2007 dues for these 21 units equaled \$94,200. JA at 367. Thus, using the County expense ratio, the full amount of expenses credited to these 21 units by the BOE was \$14,955 less than the known Association dues, alone.³

C. Manifest Error with Respect to the 2008 Assessments.

In its Brief at pages 25-27, TB Venture described in detail the gross rent multiplier methodology that the County employed in the 2008 assessments and its defects, including using a multiplier based on unrestricted apartment buildings' income and failing to take into account expenses at all, and will not repeat that analysis here.

V. THE RAILROAD CASES DO NOT ALTER THE REQUIREMENT THAT THE ASSESSOR MUST CONSIDER CONTRACT (ACTUAL) RENT.

The County places great weight on two cases involving the assessment of portions of the Potomac Yard railroad facilities, *Richmond*,

³ The only specific purported inaccuracy to which the County points in the expense projections for 2007 is: "The projected taxes set out at JA 367 assume an assessed value of \$9,500,000 for the subject units and the parking." Appellee's Brief at 11, n.9. In its haste to find fault with Appellant, the County apparently neglected to check its math. The Real Estate Taxes identified on JA at 367 total \$18,000 (\$1,500 per month for 12 months). Accepting the tax rate as provided by the County of \$.818 per \$100 of value (.00818 or .818%), \$18,000 divided by .818% equals \$2,200,489).

Fredericksburg and Potomac RR Co. v. Commonwealth, 203 Va. 294, 124 S.E.2d 206 (1962) (“*R,F&P I*”) and *Richmond, Fredericksburg and Potomac RR Co. v. State Corporation Commission*, 219 Va. 301, 247 S.E.2d 408 (1978) (“*R,F&P II*”). Neither of these cases lends much guidance in determining the appropriate methodology for assessing rental housing. As the *R,F&P I* Court noted, the property at issue was basically raw land. “Railroad operating property is mostly valueless to anyone other than the railroad, notwithstanding who may own the fee, possibility of reverter, or any other vested or contingent right.” *R,F&P II*, 219 Va. at 320, 247 S.E.2d at 419. As such and by virtue of specific statutes relating to the valuation of railroad land, these are “highest and best use” cases. “In the instant case, we are dealing with property susceptible to many uses” 203 Va. at 300, 124 S.E.2d at 211.

Although the railroad claimed that portions of the property were subject to long-term below-market leases and joint use contracts with other railroads, those railroads owned the entity that held the controlling interest in the *R,F&P* and were not considered to be a basis to reduce the value on a highest and best use. 203 Va. at 300-301, 124 S.E.2d at 211. These cases simply do not assist in determining whether rent restrictions originating from an agreement with the County to further a County public

policy reflect the economic rent, as well as the maximum permissible rent, to be used in calculating the capitalized net income of the subject units.

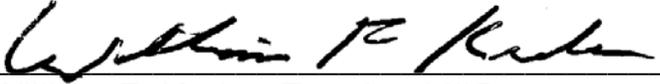
VI. THE ASSIGNMENTS OF ERROR REFLECT THE COURT'S RULINGS.

The trial court's oral opinion found that appellant failed to show a manifest error or disregard of controlling evidence. JA at 277. That ruling was a finding that the assessor was not required to consider the contemporaneous fee simple sale of the property, the restricted rents or the expenses incurred in managing those units, since each of those items are matters which this Court has found must be considered and accorded great weight. "Because neither the assessor nor the trial court factored contract rent into determination of fair market value of these properties, we will reverse the judgment..." *Clarke Assoc.*, 235 Va. at 629. 369 S.E.2d at 416.

CONCLUSION

On the basis of the foregoing, Appellant TB Venture, LLC, respectfully requests that this Honorable Court reverse the final judgment of the Trial Court, remand this case for a new trial and require use of the net income capitalization method for assessing property encumbered by low-income rental housing restrictions.

TB VENTURE, LLC
By Counsel



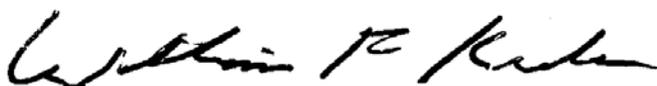
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CERTIFICATE

I, William F. Krebs, do hereby certify that, pursuant to Rule 5:26(d), fifteen bound copies and one electronic copy on CD of this Reply Brief of Appellant have been hand-filed with the Clerk of this Court and three bound copies of the same have been served, via U.S. Mail, postage prepaid, to Counsel for Appellee, this 11th day of June, 2010:

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