In The

Supreme Court of Virginia

RECORD NO. 091621

TB VENTURE, LLC,

Appellant,

v.

ARLINGTON COUNTY,

Appellee.

BRIEF OF APPELLANT

William F. Krebs (VSB No. 17347)
Jonathan C. Kinney (VSB No. 12016)
Leo S. Fisher (VSB No. 20957)
BEAN, KINNEY & KORMAN, P.C.
2300 Wilson Boulevard, Seventh Floor
Arlington, Virginia 22201
(703) 525-4000 (Telephone)
(703) 525-2207 (Facsimile)
wkrebs@beankinney.com

Counsel for Appellant

THE LEX GROUP ♦ 1108 East Main Street ♦ Suite 1400 ♦ Richmond, VA 23219
(804) 644-4419 ♦ (800) 856-4419 ♦ Fax: (804) 644-3660 ♦www.thelexgroup.com

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

STATEMENT OF THE NATURE OF THE CASE 3

I. NATURE OF THE CASE 3

II. MATERIAL PROCEEDINGS 4

ASSIGNMENTS OF ERROR 5

QUESTIONS PRESENTED 6

STATEMENT OF FACTS 8

I. THE LOW INCOME RENTAL HOUSING UNITS AT ISSUE 8

II. THE 2006 SALE TO TB VENTURES 11

III. THE FAIR MARKET VALUE OF THE SUBJECT UNITS 15

A. TB Venture's Evidence of Value 15

B. The County's Assessments 23

IV. TB VENTURE'S FINANCING OF THE SUBJECT UNITS 28

PRINCIPLES OF LAW, ARGUMENT AND AUTHORITIES 30

I. STANDARD FOR REVIEW 30

A. Standard for Review of the Granting of a Motion to Strike the Evidence 30

B. Standard to Challenge Validity of Tax Assessments 32

II. THE ASSESSOR FAILED TO CONSIDER THE ACTUAL ARMS LENGTH, CONTEMPORANEOUS PURCHASE OF THE SUBJECT UNITS. (AOE 1) 33

III. THE ASSESSOR AND TRIAL COURT FAILED TO TAKE INTO ACCOUNT THE NATURE AND CHARACTERISTICS OF THESE UNITS 36

A. The Low Income Rental Restrictions At Issue Affect The Value Of The Subject Units And Must Be Considered In The Assessment Of Their Fair Market Value. (AOEs 2 & 3) 36

B. Affordable Housing Restrictions Such As Those At Issue Further The Public Policy Of The Commonwealth As Established By The General Assembly. (AOE 2) 41

IV. THE HIGHEST AND BEST FAIR MARKET VALUE OF THE SUBJECT PROPERTIES IS AS INCOME PRODUCING RENTAL PROPERTIES UNDER COMMON MANAGEMENT WITH COMMON EXPENSES. (AOEs 3, 4 & 5) 43

V. THE COUNTY WRONGFULLY APPLIED A COUNTYWIDE EXPENSE TO INCOME RATIO, THERBY DISTORTING THE PROPERTIES' VALUES. (AOE 3) 49

CONCLUSION 50

CERTIFICATE 52

TABLE OF AUTHORITIES

Page(s)

CASES

Arlington County Brd. v. Ginsberg,
228 Va. 633, 325 S.E.2d 348 (1985) .....*passim*

Austin v. Shoney's, Inc.,
254 Va. 134, 486 S.E.2d 285 (1997) 31

Bd. of Sup. v. Donatelli & Klein,
228 Va. 620, 325 S.E.2d 342 (1985) .....*passim*

Cheswick Club, L. P. v. County of Albermarle,
273 Va. 128, 639 S.E.2d 243 (2008) 33-34

Fildak v. George,
267 Va. 612, 594 S.E.2d 610 (2004) 30

Hadeed v. Medic-24, Ltd.,
237 Va. 277, 377 S.E.2d 589 (1989) 30-31

Howertown v. Mary Immaculate Hospital,
264 Va. 272, 563 S.E.2d 671 (2002) 31

Kansas-Lincoln, L.C. v. Arlington County Board,
66 Va. Cir. 274, 2004 Va. Cir. LEXIS 320 (2004) 10, 42, 43

Nassif v. Board of Supervisors,
231 Va. 472, 345 S.E.2d 520 (1986) 37, 40, 41

Orchard Glen East, Inc. v. Bd. of Sup. of Prince William County,
254 Va. 307, 492 S.E.2d 150 (1997) 43, 44

Smith v. Board of Supervisors,
234 Va. 250, 361 S.E.2d 351 (1987) 37, 41, 50

Tuckahoe Woman's Club v. City of Richmond,
199 Va. 734, 101 S.E. 571 (1958) 34

West Creek Associates, LLC v. County of Goochland,
276 Va. 393, 665 S.E.2d 834 (2008) 32, 34, 35

Williams v. Vaughn,
214 Va. 307, 199 S.E.2d 515 (1973) 31

CONSTITUTIONAL PROVISION

VA. CONST. art. X, § 2 32

STATUTES

Va. Code § 15.2-735 10

Va. Code § 15.2-735.1 42

Va. Code § 15.2-2223.1(A) 10

Va. Code § 15.2-2283 ..... 10, 42

Va. Code § 15.2-2304 10

Va. Code § 15.2-2305 10

Va. Code § 55-79.42 48

Va. Code § 58.1-3295 ..... 5, 45, 46, 47

Va. Code § 58.1-3295(A)(1)-(3) 46

Va. Code § 58.1-3295(D) 46

Va. Code § 58.1-3984(A) 32

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

TB Venture, LLC ("TB Venture") respectfully moves this Court to reverse the judgment of the Honorable William T. Newman, Jr., Judge of the Circuit Court of Arlington County (the "Trial Court"), entered on May 8, 2009, remand this case for a new trial, and require the use of the net income capitalization method for assessing property encumbered by low income rental housing restrictions.

This case arises from the January 1, 2007 and January 1, 2008 real estate tax assessments of 21 rental units restricted for low income housing. TB Venture purchased these 21 housing units in an arms-length transaction for an aggregate price of $2 million in late 2006.[1] Under the terms of an agreement between Arlington County and the original developer these units were designated as Community Benefit Units ("CBUs"), which may only be leased to qualified low income families, at restricted rents, for the next 40 years. Notice of this Agreement, describing its principal terms, was recorded in the land records "... in order to provide notice that the Land and Project are subject to the terms and conditions of

[1] This $2 million purchase price included all 21 units along with parking and storage spaces. The parking and storage spaces are not at issue in this appeal.

the CBU Agreement with respect to those apartments (the "CBU Units")...." Joint Appendix ("JA") at 313 (Plaintiff's Exhibit 3 ¶ R-3). Notwithstanding these recorded restrictions, the Trial Court found that these properties were to be assessed as if they were not burdened for the next 40 years by either the limitation imposed on their use (rental, solely to qualified low income tenants) or the limits on rent the owner can charge (rents based on the target income level for each unit, adjusted for imputed household size).

For the two years at issue, the County Assessor's tax assessments of these properties have ranged from no less than a little over $4 million to as much as over $8 million. In granting the County's Motion to Strike the Plaintiff's Evidence, the Trial Court apparently disregarded the contemporaneous, arms-length sale of these units for $2 million, as well as the impact of the low income rental housing restrictions. Instead, the Trial Court ruled that the fee simple value of low income housing is the same as what its market value would be if it were unencumbered by the affordable housing restrictions. This holding leaves the owner exposed to taxation based on a hypothetical fair market value which it cannot begin to realize until after 2047, when the low income housing restrictions expire.

STATEMENT OF THE NATURE OF THE CASE

I. NATURE OF THE CASE

For over 25 years, this Court has repeatedly ruled that an Assessor must take into consideration both recent sales of the property being assessed and those characteristics of the property that may affect its fair market value. While a recent sale may not be determinative, it must be given substantial weight. *Arlington County Brd. v. Ginsberg*, 228 Va. 633, 641, 325 S.E.2d 348, 352 (1985). Moreover, "[e]verything which affects value must be considered." *Id*., 228 Va. at 641, 325 S.E.2d at 353.

Here, the commitment to subject these units to the low income rental limitations was a condition to the project's site plan approval. This commitment was designed to further the County's express public policy to promote the creation and preservation of affordable housing.

The Trial Court granted the County's Motion to Strike TB Venture's Evidence and, in doing so, gave no consideration to the arms length, contemporaneous sale of the very property at issue and disregarded the low income housing restrictions and burdens on the marketability of the units in determining their fair market value. JA at 276-278.

II. MATERIAL PROCEEDINGS

In response to the 2007 assessments, which assume a rate of return that vastly exceeds the return reasonably obtainable for the 40 years they are burdened by low income rental housing restrictions, TB Venture appealed to the County Board of Equalization (the "BOE"). The BOE granted partial relief and reduced the assessments from that levied by the assessor's office. In so doing, the BOE used a modified capitalized net income approach, utilizing the maximum permissible income under the CBU Agreement. However, rather than using the actual expenses in relation to the maintenance and rental of these units, the BOE applied the County's guideline capitalization rate and expense-to-income ratio used for the assessment of unrestricted rental housing units, which was considerably less than the expense ratio actually experienced by these units. Since the income for the subject units is restricted and the expenses are not, the use of the County's guideline capitalization rate and expense-to-income ratio resulted in a revised, but still excessive, assessment of $3,698,100 – a figure more than 80% higher the arms-length purchase price paid by TB Venture just a few months prior to the valuation date. JA at 103-110, 365.

Following the BOE decision and receipt of the 2008 assessments which, at more than $4 million, were significantly higher than the BOE 2007

adjustments, TB Venture brought this action in the Arlington County Circuit Court on April 18, 2008, seeking to correct the erroneous January 1, 2007 and 2008 tax assessments pursuant to Va. Code § 58.1-3295.

The case was tried on April 14 and 15, 2009. At the close of Plaintiff's case in chief, the Circuit Court sustained the County's Motion to Strike Plaintiff's Evidence and dismissed the case. The Trial Court found, as a matter of law, with respect to each of the 21 units, that its status as a condominium, rather than a rental apartment, requires that it be assessed based upon a fair market value analysis that disregards the low income housing limitations on use and income. In short, the Circuit Court required that the 21 Units be valued for what they are not, instead of what they are.

The Final Judgment was entered on May 8, 2009. Petitioner timely filed its Notice of Appeal on June 2, 2009. This Court granted the Petition for Appeal on March 26, 2010.

ASSIGNMENTS OF ERROR

1. In granting a motion to strike, the Trial Court erred in finding that the County need not consider the contemporaneous sale of the 21 CBU Units when the County assessed their value at more than double the price paid in an arms-length transaction.

2. In granting a motion to strike, the Trial Court erred in finding that the County need not consider the nature of the 21 CBU Units, including their contract rents and the restrictions imposed by the Community Benefit Housing Program Agreement ("CBU Agreement").

3. In granting a motion to strike, the Trial Court erred in finding that the County need not consider the actual and economic expenses associated with the management and maintenance of the 21 CBU Units.

4. In granting a motion to strike, the Trial Court erred in disregarding the testimony and evidence that the 21 CBU Units should be viewed as income producing property and be valued based on their capitalized net income.

5. In granting a motion to strike, the Trial Court erred in disregarding the testimony and evidence that the highest and best use for these units is as income producing properties under common management with shared expenses and that allocating the overall value of these units to the individual condominium units satisfied the statutory directive that each unit be assessed and taxed separately.

QUESTIONS PRESENTED

1. Where the uncontroverted testimony established that TB Venture purchased 21 CBU units in an arms length transaction, whether, in granting a motion to strike, the Trial Court erred when it failed to find the County

committed manifest error by failing to consider that contemporaneous sale when assessing those units at more than double their sales price. (AOE 1.)

2. Whether, in granting a motion to strike, the Trial Court erred in finding that the County need not consider the nature of the 21 Units, including their contract rents and the restrictions imposed by the Community Benefit Housing Program Agreement ("CBU Agreement"), when determining their fair market value. (AOE 2.)

3. Whether, in granting a motion to strike, the Trial Court erred in finding that the County, in determining the fair market value of the 21 CBU units, need not consider the actual and economic expenses associated with their management and maintenance. (AOE 3.)

4. Whether, in granting a motion to strike, the Trial Court erred in disregarding the testimony and evidence that the 21 Units should be viewed as income producing property and be valued based on their capitalized net income. (AOE 4.)

5. Whether, in granting a motion to strike, the Trial Court erred in disregarding the testimony and evidence that the highest and best use for these units is as income producing properties under common management with shared expenses and that allocating the overall value of these units to

the individual condominium units satisfied the statutory directive that each unit be assessed and taxed separately. (AOE 5.)

STATEMENT OF FACTS

I. THE LOW INCOME RENTAL HOUSING UNITS AT ISSUE

These 21 Units are located in a mixed use development consisting of townhouses, high-rise condominium units and retail space, known as the "Odyssey." 15th and Scott Street, LLC, ("15 & Scott") the original developer of the Odyssey, planned that the 274 residential units of the project would be rental units. JA at 280 (Plaintiff's Exhibit 1), 41. The County's site approval process conditioned the right to develop the site on the developer's commitment to reserve certain of these rental units for low income, affordable housing for an extended period. (Community Benefit Housing Program Agreement, "CBU Agreement," JA at 290 (citing Arlington County Site Plan No. 350) In furtherance of that commitment, 15th & Scott entered into a "Community Benefit Housing Program Agreement" with "The County Board of Arlington County, Virginia, acting through its County Manager, its Director of the Office of Development, and its Housing Development Coordinator," in or about January 2002. *Id.* The CBU Agreement requires that 21 Odyssey units be held for rental to low income households (JA at 290, ¶ 2) for a period of 40 years from the lease-up date

of the 11th unit.[2] (JA at 295, ¶ 7) The CBU Agreement required that a "Declaration of Covenants" be recorded among land records of Arlington County (*Id*. ¶ 8) ". . . in order to provide notice that the Land and Project are subject to the terms and conditions of the CBU Agreement with respect to those apartments…." JA at 307 (Plaintiff's Exhibit 2 ¶ R-2).

In Paragraph 2, the recorded Declaration of Covenants describes the restrictions as follows:

> For a period of forty (40) years beginning from the lease-up date of the 11th unit of the 21 units for such CBU*…, the CBU shall be rented subject to the rental restrictions thereof as are specifically set forth in Paragraph 3 of the CBU agreement*. Notwithstanding the foregoing, Declarant or any successor in title thereto, has, pursuant to the terms and conditions of this CBU agreement, the obligation to abide by the restrictions of the CBU agreement and the conditions more particularly set forth in Paragraph 5 of the CBU agreement.

JA at 313 (emphasis added). Paragraph 3 of the Agreement specifies the occupancy and rental income limitations. Paragraph 5 provides detailed

---

[2] Of the 21 Units, four are reserved for households making no more than 50%, and the balance are reserved for households making no more than 60%, of the medium income of households located within the Washington DC Metropolitan Statistical Area ("Washington MSA"). (JA at 291, ¶ 3.)

The CBU Agreement provides: "The maximum rental amounts for the CBUs will be calculated by using 30% gross income of the target income level for each CBU, adjusted for imputed household size by unit type according to the following schedule." The schedule imputes the household size of the two-bedroom units at 3 persons and for the three-bedroom townhouses at 4.5 persons. *Id*.

instructions with respect to the administration of these rental units. JA at 291, 292-293.[3]

Finally, Paragraph 4 of the Declaration provides that the Declarant, the County or any party seeking enforcement shall have the right to proceed at law or in equity against the person violating or attempting to violate any covenant or restriction contained in the Declaration or Agreement. JA at 314.

Following the entry of the CBU Agreement, MR Odyssey LLC, an affiliate of Monument Realty LLC, acquired the project. MR Odyssey altered the original development plan and subjected the residential rental apartments to a condominium regime. JA at 41. However, nothing in the registering these apartments and townhouses as condominium units altered in any manner the constraints relating to the 21 low income rental units.

---

[3] Arlington County has made the provision of affordable housing a priority since at least the 1970s and has utilized the site plan process as an inducement for obtaining commitments for new affordable housing units since the late 1980s. *Kansas-Lincoln, L.C. v. Arlington County Board*, 66 Va. Cir. 274, 277-278, 2004 Va. Cir. LEXIS 320, at 8 (2004). Over the years, the General Assembly has made it abundantly clear that the provision of affordable housing is, as a matter of public policy, a priority. *See*, *e.g.*, Va. Code §§ 15.2-735; 15.2-2304, 15.2-2305, 15.2-2223.1(A), and 15.2-2283.

II. THE 2006 SALE TO TB VENTURES

In January 2005, a representative of MR Odyssey LLC, wrote to Stanley Sloter, the President of Paradigm Development, to inform him that MR Odyssey LLC was "… interested in selling the 21 CBUs as a package to an organization that will operate the units as required by the CBU Agreement." (JA at 280.) Mr. Sloter understood that similar solicitations had been sent to other developers and nonprofit organizations with experience in managing low income rental units to solicit their offers or bids on the 21 Units. (JA at 88.)

Mr. Sloter was a logical person for Monument to approach with respect to the sale of the 21 low income rental housing units.[4] He has long been involved in promoting affordable housing issues, including serving on the boards of nonprofit organizations related to affordable housing. He is a member of the Arlington Housing Commission; he served on the District of Columbia Mayor's Task Force for Affordable Housing; and he serves on the Alexandria Affordable Housing Committee. He served on a number of committees involving and promoting affordable housing in Arlington County

[4] In 1991, after working for number of years overseeing the Washington, D.C. operations for a Pittsburgh company that built apartments, Mr. Sloter founded Paradigm. In addition to acting as a real estate developer, Paradigm has an extensive portfolio of properties that it manages, which as of trial totaled approximately 9,000 apartment units of which approximately 2,000 were affordable, low income housing units. (JA at 39)

and is involved in designing affordable low income housing programs. JA at 40-41.

Mr. Sloter analyzed the income stream that could be generated by these apartments, as limited by the low income rental housing restrictions, and deducted from that income stream actual, known and projected expenses in operating and managing those units. Significantly, the two largest expenses related to the operation of these properties were and are the monthly condominium fees and the real estate taxes. JA 318, Plaintiff's Exhibit 4. As Mr. Sloter explained:

> As we assess, these sorts of units are only rental units. They have to be rented and be rented to people who qualify. Their incomes are restricted, so part of our strategy in trying to decide how much we can afford to pay [to purchase the units] is to determine, first of all, how much rent we can get at a maximum. Not every unit. We have to take in account some level of vacancy because these things turnover. And we have to deduct from that total revenue those expenses that we are going to incur, which would include -- the biggest expense of, which is the condominium fee and then real estate taxes and marketing expenses and the other stuff it would take to keep these units operating.

JA at 43-44.

Once he calculated the projected net operating income, he determined his anticipated rate of return on the total cost. In assuming a $2 million purchase price, Mr. Sloter calculated that, in the year 2007, the net operating income would be $150,481 and in 2008 approximately $153,297.

The return on total cost would be 7.36% for 2007 and 7.5% for 2008. In calculating the net operating income and return on total cost, Mr. Sloter calculated the real estate tax expense by applying the tax rate against his proposed purchase price. (JA at 51; JA 318, Plaintiff's Exhibit No. 4) Mr. Sloter explained his reasoning as follows:

> The effect of the entire document [Plaintiff's Exhibit No. 4] . . . -- below the black line is the projection, so the first year of the projection is 2006. The revenue just comes from that income section of what the apartments are renting for. I have some parking there, total revenues $294,000 projected. The[n] I deduct $144,000 in total expenses. It gives me net operating income of $149,000, so then we base our valuation on whether we should -- how much we should pay for this property, based on that $149,000 number. That's how many dollars I have available to service the debt. You can see, I have an assumption in here, but to service the debt or service the equity, at the very last line item on the page, is return on cost which is 7.32 percent, or so, in effect, that's the cap rate. We are saying at a $2 million acquisition price, we thought we could generate 7.32% if we were right on all these assumptions and then hope that that was adequate.

JA at 51-52.

This analysis is similar to a valuation calculated through the net income direct capitalization methodology, with the return on total cost the equivalent of the direct capitalization rate. *Id*.; JA at 168 (Thomas Shields, MAI, plaintiff's expert appraiser, testified that the capitalization rate "is the net operating income divided by the sales price.").

While Mr. Sloter recognized that these apartments consisted of 21 separate condominium units, he did not use the sales of unrestricted units in the same building as comparable sales in determining value because they simply were not comparable:

> I was required to rent them [the 21 units at issue]. I was required to rent them to restricted people [at] that restricted rental rate. None of the other units were under that burden, and if you weren't under that burden, but somebody else is willing to pay for your unit is just not relevant to me in the evaluating what the units are worth from an economic standpoint.

JA at 53.

Similarly, because the maximum income is limited by the recorded rent restrictions, the relative location of a unit within the building, which might make a significant valuation difference with respect to unrestricted units, is irrelevant.

> There is no difference in value between the 9th floor and the first floor because the rental rates are the same. The thing that determines which units -- if you go through -- if you go through the analysis that I have here you can see that there are two bedroom units at 50 percent and two-bedroom units at 60 percent, three-bedroom units at 50 percent and three-bedroom units at 60 percent. Whether they are 50 or 60 percent of varying medium-income units, they would have more value. For example, in the two-bedroom case, the 50 percent units I could rent for $963. The 60 percent, I can rent for $1,064. That difference would create a difference in value, that difference doesn't care at all whether it's a townhouse or flat or unit on the top floor with a great view it makes no difference.

JA at 55.

TB Venture successfully offered $2 million for the 21 Units. That price was a direct result of Mr. Sloter's analysis of the maximum projected income, anticipated expenses, anticipated rate of return and ability to service debt relating to those 21 units. He neither sought nor received a discount for purchasing the 21 units in bulk. JA 318-328 (Plaintiff's Exhibit 4).

The purchase contract was originally entered into by Paradigm Development Company on March 1, 2005 and assigned to TB Venture on June 27, 2006. JA 329. TB Venture closed on the first 20 units on September 8, 2006. It closed on the final unit on February 22, 2007, once the seller completed the handicapped accessibility modifications to that unit. Clearly this purchase was at arms length. JA at 62.

III. THE FAIR MARKET VALUE OF THE SUBJECT UNITS

A. TB Venture's Evidence of Value

Despite their luxury trappings, the burdens of the CBU, low income housing program limit and determine the units' values. Under the program, there is no ability to vary the rent on the basis of quality of construction, amenities, location or even view. Regardless of whether a unit is on the second floor or the ninth floor of the building (with a view of the D.C. monuments), there is no rent differential. The only factors that affect the

amount of the rent are the imputed size of the household based on the number of bedrooms and the target level income for the imputed household.

While the rent for each unit was limited to the target level for that household, the expenses were not. By using the economies of scale from his existing management and maintenance infrastructure, Mr. Sloter believed he would achieve greater savings in those operations than his competitors which, in turn, allowed him to submit a higher bid than could they. JA at 50.

Thomas J. Shields, MAI, testified as an expert appraiser for TB Venture. He testified that he had extensive experience in appraising low income affordable housing and projects containing affordable housing, but that he had never before encountered affordable housing condominium units which may only be leased.[5] JA at 155. He was aware of the only other sale of CBU units in Arlington County. That 2008 sale consisted of all seven CBU units in the condominium complex known as the Grove. Other

[5] Mr. Shields has been the Regional Manager for the mid-Atlantic Region of Joseph J. Blake and Associates, a commercial real estate appraisal company with 10 offices around the country, since 1992 and received his license to appraise Virginia real estate in 1993. JA 150-151. He is familiar with the valuation of property consisting of or containing affordable housing units and other problems associated with appraising properties that constitute low income housing. Within just the last year prior to the trial in this matter, Mr. Shields had appraised approximately seven low income properties, not including the properties at issue. JA at 153-154.

than the sale of the subject units and the seven units in the Grove, he was unable to locate any other sales of Community Benefit Units. JA at 162. The sales price of the Grove units was consistent with MR Odyssey's sale to TB Venture and Shields' conclusions of market value based on the subject units' capitalized net income. JA at 188-190.

Mr. Shields concluded that the restrictions contained in the CBU Agreement rendered any efforts to develop a market value based upon comparable sales inappropriate. There were no single unit comparable sales. The differences between restricted units and unrestricted units are simply too great for any such comparison to be valid. (JA at 162) "It is my opinion that a buyer would consider the income capitalization approach only." (*Id*.)

Because the CBU Agreement requires these units to remain as rental apartments for 40 years, their fair market value is determined by the limited income they can generate as low income housing units. JA at 156. Accordingly, Mr. Shields used a valuation technique which he referred to as a "Leased Fee" appraisal.

> Leased fee takes into account the covenant that encumbered the 21 Units. The fee simple would not. In other words, we would either – we would look at the highest and best use of those 21 Units. If it would be to rent them at market rates, we would value it that way. If it was to sell them as condominiums,

> then we would look at it both ways, and the highest value would be the highest and best use under fee simple.

JA at 158. If the units were not encumbered by the CBU covenant, they would "absolutely sell for much more." *Id*. Using Mr. Shields' terminology, the difference between a Leased Fee and a fee simple valuation is that the leased fee takes into consideration the actual characteristics of these properties, which limit their highest and best use to low income rental housing, while the County's "fee simple" analysis assumes the absence of those very encumbrances and limitations. JA at 160.

He determined the amount of the maximum permissible rents for these units under the CBU Agreement, examined the historic and projected expenses provided to him by TB Venture. He identified certain expenses which TB Venture paid less than the market. Since a purchaser of these units would be presumed to have to pay the market rate for those items, he made adjustments to reflect the economic rate for those expenses.[6] For

---

[6] Mr. Shields testified that his understanding of the CBU Agreement required the developer or its successors to operate all 21 Units and they could not be sold individually. (JA at 170) He further opined that, even if one could permissibly sell them individually, there would be little to no market for a single unit given the CBU restrictions. The cost of operating a single CBU loses the efficiencies of economy of scale and the anticipated expenses on a per unit basis would be significantly higher. Thus, this is an instance where the value of each unit is enhanced by treating it as part of the management portfolio with other similar units over which fixed and common costs may be allocated.

instance, Mr. Shields used a 2.5 percent management fee in his analysis to reflect the prevailing rate in the local market while Paradigm charged TB Ventures a 1 percent management fee. JA. at 166-167. Similarly, Mr. Shields used the economic insurance costs which a third-party purchaser would be expected to incur, $100 per unit, rather than the actual premium cost of $50 per unit incurred by TB Venture. JA at 166.

After determining the maximum permissible rents and deducting the appropriate expenses, as adjusted to reflect economic expenses, Mr. Shields calculated the net income obtainable from these units and applied a 7% capitalization rate to determine the value of the units. JA at 168-169. Mr. Shields concluded that the 21 Units had a fair market value at January 1, 2007 of $2,160,000 and as of January 1, 2008 a fair market value of $2,050,000. JA at 171. In order to provide a per unit valuation for each of these condominiums, he allocated those values among the 21 Units based on a *pro rata* share of the income of each unit of the overall income and applied that to the overall market value.[7] JA at 172-173.

---

[7] When asked why he did not do a separate analysis for each individual unit, Mr. Shields testified, "Well, I didn't find any instances where there would be demand from one buyer buying one rent-restricted unit as an investment and – again, this is the other main reason is . . . my understanding is these 21 Units are basically tied together through this covenant and cannot be sold off separately . . . ." (4/14/2009 Tr. at 170)

Mr. Shields testified that, in determining the value of these units, their registration as condominium units did not affect the highest and best use for those units or their value. Although individual condominium units may be freely sold on an individual basis, Mr. Shields recognized that the requirement that these units may only be rented, at restricted rents, for the next 40 years effectively stripped those units of the market value normally associated with the freedom to sell unencumbered condominium units. Since they could not be owner-occupied and were required to be held for rent, Mr. Shields opined that their fair market value was limited by the value of the capitalized net income these units generated through the restricted rents. "No, because the restrictions were for what I consider to be a long period of time, 40 years, so I approached it primarily as a rental property, since the units -- is my understanding that the units cannot be sold individually as condominiums, and there were -- 21 were under this restricted covenant." JA at 156. Mr. Shields went on to explain:

> A leased fee is when the property that we're appraising is encumbered by what I would consider a long-term lease agreement. In this case, I consider long-term anything over one year. In this case, 40 years. You know, the property is encumbered by this agreement for 40 years, so therefore, it's -- the value is subject to this covenant in place.

JA at 157-158. On cross examination he provided the following explanation:

Q. Is it fair to say that the leased fee is essentially your capitalization of the restricted income coming into the property?

A. Yes. Primarily, yes.

JA at 175.

After 40 years, the units will become unencumbered. Shields did not attribute any residuary value to reflect the units' worth after 40 years. "In my opinion, that [40 years] was too far out into the future that any buyer looking at the property today would look at the income in place, especially given that that income is restricted for 40 years, so I looked at it on a direct cap one-year projected income basis." JA at 159. Mr. Shields went on to note that it is not an accepted practice for appraisals to attribute a residuary value to property 40 years into the future. "Because it's so far out in the future, the discounting of -- first of all, the projecting of value 40 years from now is extremely subject[ive], first of all. Second of all, the discounting that would be necessary to discount any value after 40 years to today would give it minimal value in regard to the overall property." JA 159-160.

Mr. Sloter was also questioned concerning this asserted residuary value during the County's cross examination:

Q. So at the end of 40 years, you can sell these units, right?

A. I suppose that's true. The restriction will go away.

> Q. You did not include that value in your pro formas, did you?
>
> A. We did not.
>
> Q. You're aware, aren't you, there are many apartment buildings in Arlington County that are 40 years old or more?
>
> A. There are.
>
> Q. You have to concede, wouldn't you, those units have value?
>
> A. They do.

JA at 90. Of course, that questioning was, at best, misleading. As pointed out in redirect, there is a significant difference between the current value of a 40 year old building and the current value of a building 40 years from now:

> Q. What today is the value of the Odyssey, 40 years from now?
>
> A. That's a very different question. In fact some buildings have value that are 40 years old. I'm 50 years old. I still think I have value, but the value of something that you don't receive for 40 years is quite different. There is a present value calculation that you have to take into account, which is another entire way of valuing anything as an alternative to capitalization approach. You take all the revenue streams you expect over forever in that scenario. You will put a value out there, but you would then have to discount that by a factor to come back to today you'll find that the -- that having some value 40 years from now is worth next to nothing today.

JA at 94.

B. The County's Assessments

As of January 1, 2007, the County assessed the 21 subject units at an aggregate value of $8,370,400 – more than quadruple the arms-length price paid by TB Venture just months earlier. That assessed value was based upon the County's sales comparison approach in which the comparable sales were unrestricted luxury condominiums. JA at 204-205. The assessor did not consider making adjustments due to any impact the CBU Agreement and its terms had on the value of the units. Moreover, he disregarded TB Venture's contemporaneous purchase of these units. "The actual sales were considered, but they were discounted because they were bulk sales." JA at 213. However, at the time his office "discounted" the actual sale of the units, it made no effort to determine what, if any, impact the "bulk" nature of the sale might have had on determining the purchase price:

> Q. But you don't know whether the bulk sale increased the price or decreased the price?
>
> A. [Mr. Rice] No, I don't.

JA at 219. Although the 21 units were sold together, there was no evidence of a bulk or quantity discount in the purchase price.

TB Venture appealed to the BOE.[8] The BOE viewed these parcels as income producing property and lowered the assessment by use of a modification of the direct capitalization method. While the BOE used the income generated by the 21 units as a whole, it did not use their actual expenses. The BOE used an expense ratio developed by the assessor's office for recently constructed high-rise apartments unencumbered by low income housing restrictions. The County's guideline expense ratio the BOE used was 25% of the income generated. JA at 105-109. In contrast, based on TB Venture's actual costs,[9] Mr. Shields calculated the actual expense ratio for the subject units for 2007 at 39%. JA at172. After determining the total value of all 21 units, the BOE then allocated that value among the 21

---

[8] Following the initial assessment, TB Ventures filed an administrative appeal with the assessor's office. In response to the appeal, the County developed a Gross Income Multiplier approach to valuation. JA at 205-206. That approach is discussed in more detail below with respect to the 2008 assessments. However, while the result reflected a significant decrease from the $8 million assessment, it was still considerably more than the purchase price of these units (and more than the BOE's corrected assessment). Since TB Venture did not agree to that revised number, it was never adopted as an assessment.

[9] Since 2007 was the first year that any of these units were rented, the "actual expenses" for both 2007 and 2008 consisted of those expenses which had been incurred or the amounts were known, and the projected expenses based on the characteristics of these units viewed in light of Paradigm's experience in managing such units.

units to obtain a condominium by condominium assessed value. JA at 370-415 (excerpts from Plaintiff's Exhibit 7).

The 2008 assessment valued these properties in the aggregate at $4,058,400. This assessment was derived through the County's use of a Gross Rent Multiplier. In apparent recognition that these units are income producing, the County examined unrestricted luxury condominiums which were rented to third parties and divided the assessed value by the rental income they generated, thereby obtaining a Gross Rent Multiplier. The County then multiplied that ratio against the individual units' income to determine its assessed value. JA at 205-206. Using this methodology, the County completely disregarded the actual expenses incurred in managing and maintaining these units.

Additionally, the County failed to take into account that the expense to income ratio for low income housing, where the income is restricted but expenses are not, is significantly higher than that for unrestricted housing. By and large, these expenses are not within the owner's control; for instance, the condominium fees are the largest expenditures relating to these units. Yet, those fees are determined by all of the unit owners in the Odyssey. Thus, even if the gross income multiplier approach had some validity for the comparison of like, unrestricted properties with similar

expense to income ratios, the County's Multiplier has no application when applied to rent restricted low income housing. Both Mr. Sloter (JA at 60) and Mr. Shields (JA at 163-164) testified that using a Gross Rent Multiplier is not a commonly accepted method used by developers or appraisers to determine fair market value.

Mr. Rice acknowledged that the only properties assessed by Arlington County using the Gross Rent Multiplier approach are the community benefit units. He developed that method because these affordable housing units contain limitations which must be accounted for in determining their fair market value. When asked to identify the characteristics of these units that caused him to use this methodology, Mr. Rice conceded:

> That they have a long-term restriction on the rent for the property. That they're encumbered for 40 years. That the -- that they exist as single-family properties under the State Tax Code, and the other methods that are available to assess the properties are not available or readily available in the marketplace to do so.

JA at 218. Yet when asked, "Is there a reason you could not do an income capitalization methodology?" Mr. Rice acknowledged that he could have used that approach:

> There's no reason why I couldn't have done one [valuation by income capitalization method], but the objective is how do you establish what the -- what the appropriate expenses are for the property and what the pro rata capitalization rate would be for

> the individual property, and I could find no market evidence of either of those.

JA at 218. The reason he could find no market evidence of individual sales is that there were none; the sales he did know about, the subject properties and the CBU condominiums at the Grove, he arbitrarily ignored ("discounted") because they were, in his view, "bulk sales." JA at 219.

Mr. Rice acknowledged that he had received from TB Venture the actual expenses relating to the subject units, but he disregarded them because those expenses applied to the 21 units as a whole. JA at 219-220. Mr. Rice never asked TB Venture for a per unit breakout of the expenses. JA at 226. Instead, he developed a methodology that did not take into account actual expenses incurred in the operation of these units (JA 220), even though, as Mr. Shields testified, those expenses, in 2007, constituted 39 percent and, in 2008, 41.6% of the gross income generated by the rental of these units. JA at 172.[10]

---

[10] The exclusion of expenses by use of a Gross Income Multiplier can easily result in a distorted value. For instance, in Mr. Rice's "Retrospective Analysis" (a modification of the method to calculate the Gross Rent Multiplier), Mr. Rice calculated an alternate valuation for both 2007 and 2008. Under his methodology, 2008's value was an increase over 2007, because 2008's gross income increased slightly. However, using a net income capitalization approach, Mr. Shields concluded that 2008's value of these units was actually less than that of 2007 because the expenses increased more than did the gross income, a result Mr. Rice acknowledged his method would not take into account. JA at 228.

IV. TB VENTURE'S FINANCING OF THE SUBJECT UNITS

Both when it contracted for the units and settled on them, TB Ventures had not sought third-party financing. Mr. Sloter believed that one of the reasons that TB Ventures was the prevailing purchaser was his ability to offer a no financing contingency contract. JA at 63. However, by the end of 2007 and certainly after the BOE decision, Mr. Sloter decided to free up some of the $2 million committed to this project and seek financing on these units. JA at 67-68. Michael Butler, a senior level Project Manager concentrating on accounting and finance issues for Paradigm, headed up that effort. JA at 68.

Mr. Butler prepared a memorandum along with supporting documentation to submit to lenders that might be interested in making this loan. He received a positive response from most of the potential lenders, (JA at 112) and he eventually focused primarily on placing a loan from the Virginia Housing Development Authority (VHDA). JA at 113. TB Venture was seeking a loan in the amount of $1.6 million under a VHDA program that would loan up to 90 percent of the value of the property (that ratio is referred to as the "loan to value ratio"), assuming other requirements were met. Assisting Mr. Butler with respect to the VHDA loan process was

Charles Wilson, a VHDA approved loan broker retained by TB Venture. JA at 113.

Mr. Wilson, using information provided by Mr. Butler, prepared a loan application that Mr. Sloter signed. JA at 113; 69. Mr. Wilson, in completing the application, disclosed the $2 million purchase price. JA 353, Box entitled "Site Control," as well as the recently revised 2007 tax assessment. JA 353, Box entitled "Real Estate Tax Information." In its supporting worksheets, Mr. Wilson showed the Cash Flow Summary illustrating the ability to service the debt out of its Net Operating Income, leaving $48,207 for distribution after debt service. JA at 362.

Also in the supporting worksheets, Mr. Wilson broke out the value or cost of a number of specific items relating to the proposed loan. In the section referred to as "Loan Ratios," Mr. Wilson provided an estimated capitalization rate of 6.75% (JA at 362), which is less than the 7% before real estate tax used by Shields. JA at 168-169. Mr. Wilson then calculated the "Value by Capitalization" of the 21 units plus parking spaces and storage areas at $2,186,804. JA at 362. The very next line in the form is "Total Estimated Value." Earlier in the form, in the "Development Summary" section, Mr. Wilson had entered $3,690,100, the BOE's revised assessment, and Mr. Butler caused that number to be marked with an

asterisk and the legend in that box stating "**2007 Arlington County Assessment*." JA at 115, 351 (emphasis in original). Mr. Wilson reentered that number directly below the "value by capitalization" value on the worksheet. JA at 362.

The VHDA reviewed the loan application and issued a commitment letter. However, VHDA instructed TB Venture to submit a third-party appraisal, indicating that it was not comfortable with the assessed values given the restrictions on the units. JA at 232-233. Pursuant to that requirement, Mr. Shields provided an appraisal opining that the 21 units, parking spaces and storage spaces, combined, were worth no less than $2,200,000. JA at 233-234. At that value, the loan to value ratio on this loan equaled 72.7 percent. After receipt of Mr. Shields' "not less than appraisal," the VHDA closed on and funded the loan.

PRINCIPLES OF LAW, ARGUMENT AND AUTHORITIES

I. STANDARD FOR REVIEW.

A. Standard for Review of the Granting of a Motion to Strike the Evidence.

In considering a circuit court's decision to grant a motion to strike, this Court views the facts in the light most favorable to the plaintiff and draws all fair inferences from those facts. *Fildak v. George*, 267 Va. 612, 619, 594 S.E.2d 610, 614 (2004), *Hadeed v. Medic-24, Ltd*., 237 Va. 277, 281, 377

S.E.2d 589, 590 (1989). Further, the Trial Court should only grant the motion when "it is conclusively apparent that plaintiff has proven no cause of action against defendant or when it plainly appears that the Trial Court would be compelled to set aside any verdict found for the plaintiff as being without evidence to support it." *Williams v. Vaughn*, 214 Va. 307, 309, 199 S.E.2d 515, 517 (1973) (internal citations omitted).

In ruling on a motion to strike, unless sworn testimony and evidence are irreconcilable with logic and human experience, the court must accept that testimony and evidence as true and draw all favorable inferences which a jury might draw from the evidence. *Id*. at 310 (reversing the granting of a motion to strike), *see also Austin v. Shoney's, Inc.*, 254 Va. 134, 138, 486 S.E.2d 285, 287 (1997). The court may not assess the weight and credibility of the evidence in rejecting inferences favorable to the plaintiffs which do not defy common sense. *Howertown v. Mary Immaculate Hospital*, 264 Va. 272, 278, 563 S.E.2d 671, 674 (2002).

The Circuit Court did not view the evidence consistent with this standard when it sustained the County's Motion to Strike the Plaintiff's Evidence.

B. Standard to Challenge Validity of Tax Assessments.

The standard for challenging the validity of a real estate tax assessment, whether residential or commercial, apartment or condominium, is set forth in Virginia Code § 58.1-3984(A). "In such proceeding the burden of proof shall be upon the taxpayer to show that the property in question is valued at more than its fair market value or that the assessment is not uniform in its application, or the assessment is otherwise invalid or illegal." This standard is mandated by Article X, § 2 of the Constitution of Virginia, which protects all taxpayers from assessments in excess of fair market value.

Although the taxpayer is required to show that the County committed manifest error in the assessment, that error can be demonstrated either through a showing that the assessor made an error in the methodology used for the assessment, or by showing that the assessed value significantly exceeds the fair market value of the property. *West Creek Associates, LLC v. County of Goochland*, 276 Va. 393, 413-414, 665 S.E.2d 834, 845 (2008). Where the claimed error is based on the disparity of values, that disparity must constitute something more than a simple difference of opinion among experts. *Id.* In this case, TB Venture has demonstrated both factors. The failure of the assessor to give proper

weight to the contemporaneous sale of the properties, the BOE's use of a countywide expense to revenue ratio with respect to the 2007 assessment and the assessor's use of a gross income multiplier methodology for the 2008 assessment, which does not take into account the greater proportional expenses for affordable housing, all constitute manifest error.

The fair market value of these units falls within a good-faith range of approximately $2 million to $2.2 million, as indicated by: (a) the contemporaneous purchase price (including parking and storage space) of $2 million; (b) Mr. Wilson's income capitalization valuation of these units (also including parking and storage spaces) at $2,186,804, and (c) Mr. Shields' fair market value calculation of these units at $2,160,000 for 2007 and $2,050,000 for 2008. The BOE's valuation of $3,698,100 for 2007 and the assessment for 2008 of $4,480,400 certainly fall well outside "the range for a reasonable difference of opinion."

II. THE ASSESSOR FAILED TO CONSIDER THE ACTUAL ARMS LENGTH, CONTEMPORANEOUS PURCHASE OF THE SUBJECT UNITS. (AOE 1)

"We have defined fair market value of the property as a sales price when offered for sale 'by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it.'" *Cheswick Club, L. P. v. County of Albermarle*, 273 Va. 128, 136, 639 S.E.2d 243, 247

(2008), *citing Tuckahoe Woman's Club v. City of Richmond*, 199 Va. 734, 737, 101 S.E. 571, 574 (1958). Consistent with that definition, this Court has consistently held that the assessor must consider the recent sales price of the property at issue. "The recent sale price of property is not conclusive evidence but is to be given substantial weight in determining fair market value." *Ginsberg*, 228 Va. at 641, 325 S.E.2d at 353, *citing Bd. of Sup. v. Donatelli & Klein*, 228 Va. 620, 628, 325 S.E.2d 342, 345 (1985).

In *Donatelli & Klein*, the County did not consider the actual recent sale of the subject property because the purchase had the trappings of a bulk sale. "The County's witnesses stated they did not consider the actual sales data because the properties were sold as a package with special financing subject to the existing leases. These factors, they indicated, would make the purchase prices suspect as indicators of fair market value." 228 Va. at 626-627, 325 S.E.2d at 345. The Trial Court and this Court rejected the County's argument because, while the land was bought in bulk, the sales price did not reflect a bulk discount. "On rebuttal for the Taxpayers, Gates reiterated that the total sale price was not discounted because the properties were sold as a package." *Id*.

In *West Creek Assoc.*, the purchaser contracted to buy 2,500 acres, which at closing were conveyed as 144 individually titled parcels. The

overall price for the 2,500 acres reflected a bulk discount, and this Court found that this bulk discount was not indicative of the value of the 144 individual smaller parcels when allocated on a per acre basis. 276 Va. at 416-417, 665 S.E.2d at 847.

Here, there is uncontroverted evidence that the price TB Venture paid for the 21 Units was not discounted for bulk or volume. Rather, its bid was a direct result of the projected net income and a valuation of the anticipated return on investment based on the revenue and expenses considering all 21 Units. JA at 318 (Plaintiff's Exhibit No. 4)

Thomas Rice, the County Assessor, testified, "The actual sales were considered, but they were discounted because they were bulk sales." (4/14/2009 Tr. at 219.) However, he admitted that, at the time he "discounted" them, he did not know whether the bulk sale had the effect of increasing or decreasing the price. *Id*. Yet, throughout the trial, the County questioned each TB Venture witness concerning the fact that the units were all sold in one transaction, thus in the County's view constituting a "bulk sale." JA at 87-88, 123-124, 177. Each time, however, the County stopped short and did not inquire as to whether there was any impact on the purchase price by virtue of the fact that the units were purchased in bulk. As this Court recognized in *Donatelli & Klein, Inc.*, just because a

number of parcels are purchased simultaneously does not mean that there was a resulting discount. The failure of the assessor to consider the contemporaneous sale of the subject units constituted manifest error in the absence of any volume or bulk discount. 228 Va. at 626-627, 325 S.E.2d at 345.[11]

III. THE ASSESSOR AND TRIAL COURT FAILED TO TAKE INTO ACCOUNT THE NATURE AND CHARACTERISTICS OF THESE UNITS.

A. The Low Income Rental Restrictions At Issue Affect The Value Of The Subject Units And Must Be Considered In The Assessment Of Their Fair Market Value. (AOEs 2 & 3)

This Court has consistently ruled that, in determining fair market value, the assessor must take into account the nature and characteristics of the specific property being appraised. "Everything which affects value must be considered." *Ginsberg*, 228 Va. at 641, 325 S.E.2d at 353. "We held that the County's approach, whether simple averaging of rents or a more

---

[11] The County also claims that the arms length sale of these units should be disregarded because there was a unified price for all 21 units while the assessor must assess each unit separately. Therefore, the argument goes, the assessor need not consider the unified price. That argument misses the mark.

Since there was no bulk discount in TB Venture's purchase price, that price should have served as a check as to the overall value of those units. The County was required to consider it and to give it great weight. For instance, the huge amount of variance in the arms length sales price and the initial $8 million assessment should have alerted the Assessor that his values were well beyond fair market.

complex development of theoretical, market-wide rent levels, failed to meet our definition of economic rent 'because it leads to values unrelated to the specific property being appraised.'" *Smith v. Board of Supervisors*, 234 Va. 250, 256, 361 S.E.2d 351, 354 (1987), *citing Nassif v. Board of Supervisors*, 231 Va. 472, 484, 345 S.E.2d 520, 527 (1986) (*Nassif II*). The assessment must relate to the "specific property being appraised." *Nassif II*, 231 Va. at 484, 345 S.E.2d at 527. *Ginsberg*, 228 Va. at 641-642, 325 S.E.2d at 353.

In valuing the subject units, Mr. Shields did not use the comparative sales approach. That approach would have captured the value an owner occupant would pay to live in a luxury condominium with the amenities flowing therefrom, including, depending upon the unit, a view of the Washington, DC Mall and monuments. An owner occupant would also have the ability to sell that unit to another owner occupant in the future. The reason Mr. Shields did not use this approach is readily apparent. An owner occupant, desiring to purchase such a unit, could purchase any available unit in the Odyssey complex at the price the market would bear, except any of the 21 units at issue here (which are required to be rented to qualified, low income applicants).

No matter how much a potential owner occupant might be willing to pay for one of these units, TB Venture may not sell him a unit regardless of the price. Rather, a purchaser of any and all of these units (assuming, *arguendo*, that less than all of the units may be sold) cannot live in the unit, cannot enjoy the amenities related to the unit, and cannot sell it to someone else who would like to live in the unit. Such a purchaser would not even be able to rent the unit based on market value of the view, amenities, location or demand for such unit. Rather, a purchaser may only attain the income stream realized from the rent generated and calculated based on a formula solely dependent on imputed household size determined by the number of bedrooms.

Accordingly, Mr. Shields valued these parcels using "[t]he direct capitalization methodology, which projected one year, a stabilized year of income and expenses to derive at a net operating income. That net income operating income is capitalized at an appropriate capitalization rate to determine the market value." JA. at 161.

With respect to income generating property, "[a]s a general rule, determination of fair market value by capitalization of economic rents is the preferred method, but the consideration of contract rents is required in ascertaining economic rents. [Citation omitted] Where there has been a

recent sale of the property, of course, such sale should be considered. [Citation omitted]" *Ginsberg*, 228 Va. at 641-642, 325 S.E.2d 353. "We held instead that contract rents must be considered in establishing economic rents by which the fair market value is determined. Although the interest to be valued is the fee, consideration of the actual income from existing contracts is mandated." *Donatelli & Klein*, 228 Va. at 631, 325 S.E.2d at 348. Significantly, much of the focus of this Court's discussion revolved around the valuation of the Cedar Ridge Apartments.

Cedar Ridge was a federally sponsored, low income housing apartment complex, subject to a 20 year Federal Housing Authority ("FHA") regulatory agreement imposing a rent and profit ceiling. Recognizing those restrictions and the resulting negative cash flow, the taxpayer's experts appraised Cedar Ridge Building at no more than the balance on its outstanding mortgage (in 1974 that building produced a significant net loss). However, it appears that the County in that case treated the negative impact of the FHA low income housing burdens as a "leasehold" interest. In effect, the County valued the difference between the actual rents permissible under the low income housing constraints and the unconstrained market rents as a taxable "leasehold" interest. *Donatelli & Klein*, 228 Va. at 627, 325 S.E.2d at 345.

> The County asserts that the use of actual income and expense figures creates an unconstitutional tax exemption for the properties to the extent that less than the entire estate is taxed. Where there is a lease producing actual income that is below the market, the County says, the leasehold would be exempt from taxation under the appraisal method approved by the trial court.

228 Va. at 631, 325 S.E.2d at 347.

This Court rejected that approach, finding: "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." 228 Va. at 631-632, 325 S.E.2d at 348.

Here the Trial Court disapproved of the direct capitalization methodology to value the "leased fee" because it did not value the "fee simple." JA at 277. In so doing, the Trial Court committed the same error. The only difference is the court's use of the term "fee simple" in lieu of "leasehold interest." Shields' approach was exactly that which this Court has found to be the preferred method for valuing income producing property. "As a general rule, economic rent is the measure to be used in capitalizing income for fair-market-value determination; however, contract rent is relevant as evidence of economic rent." *Nassif II*, 231 Va. at 405, 290 S.E.2d at 825. In discussing that holding, this Court observed:

> We pointed out that we had defined economic rent as the amount that a typical lessee should be willing to pay for the right to use and occupy the premises for a stated period. We added, "[t]hat definition focuses upon the property that is being valued and plainly indicates that the determination of economic rent must be specific to the property under review as opposed to some abstract or theoretical property."

Smith, 234 Va. at 256, 361 S.E.2d at 355, discussing and citing *Nassif II*. The Trial Court in this case found that direct capitalization of economic rent for income producing property is an improper method of valuation -- a finding in direct conflict with this Court's opinions over the past twenty-five years.

B. Affordable Housing Restrictions Such As Those At Issue Further The Public Policy Of The Commonwealth As Established By The General Assembly. (AOE 2)

It appears that a linchpin of the County's position is that, taking into account the market impact of the low income housing restrictions and valuing the subject units based upon their capitalized net income, violates the directive that the property should be assessed at its fee simple value. A corollary of that linchpin is that any valuation methodology taking into account a recorded restriction placed on the property that would negatively influence how much a willing purchaser would pay is inappropriate.

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. Va. Code § 15.2-2283 provides:

> Zoning ordinances shall be for the general purpose of promoting the health, safety or general welfare of the public and of further accomplishing the objectives of § 15.2-2200. To these ends, such ordinances shall be designed to give reasonable consideration to each of the following purposes, where applicable: . . . (x) to promote the creation and preservation of affordable housing suitable for meeting the current and future needs of the locality as well as a reasonable proportion of the current and future needs of the planning district within which the locality situated . . . .

In 2006, Va. Code § 15.2-735.1 was enacted to specifically authorize the County to condition a special exception for a residential, commercial or mixed-use project with a FAR of 1.0 or greater on the applicant providing on-site (subject to buyout or offsite substitution options) "Affordable Dwelling Units" constituting five percent of the gross floor area of the project exceeding 1.0 FAR. This statute followed the Arlington County Circuit Court's opinion in *Kansas-Lincoln, L.C.*, *supra*, 66 Va. Cir. 274, 2004 Va. Cir. LEXIS 320 (2004), in which the Court invalidated Arlington County's Affordable Housing Guidelines of a similar effect to the extent that they required, without express authority from the Legislature, an applicant to provide affordable housing or contribute to the County's affordable housing fund in order to obtain site plan approval. The Court recognized, "Thus, the Legislature has said that affordable housing for all income levels must be

considered in comprehensive planning." The Court recognized that the County had an obligation to promote affordable housing and to develop appropriate policies in order to do so. 66 Va. Cir. at 281-282**,** 2004 Va. Cir. LEXIS 320 at 16-17. Yet, the County would have this Court find that the affordable housing restrictions such as those on the units in question, at least as to condominiums, are artificial, voluntary and noneconomic constraints which may be ignored for the purpose of real estate taxation assessments.

IV. THE HIGHEST AND BEST FAIR MARKET VALUE OF THE SUBJECT PROPERTIES IS AS INCOME PRODUCING RENTAL PROPERTIES UNDER COMMON MANAGEMENT WITH COMMON EXPENSES. (AOEs 3, 4 & 5)

In *Orchard Glen East, Inc. v. Bd. of Sup. of Prince William County*, 254 Va. 307, 492 S.E.2d 150 (1997), this Court considered the assessment of a condominium apartment building the developer/taxpayer elected to continue to hold and rent as apartments. The taxpayer sought a reduced tax assessment on the grounds that the units should be treated as a unified apartment building. In denying the taxpayer relief, this Court noted that, as legally registered condominiums available for sale, they were not in the same class of property as apartment units not for sale. *Orchard Glen East*, 254 Va. at 313, 492 S.E.2d at 154.

Moreover, this Court accepted the finding that there was a market for these units as condominiums and that their cumulative sales' values as

condominiums exceeded the value of the building as apartments. *Orchard Glen East*, 254 Va. at 313-14, 492 S.E.2d at 154. Contrary to that situation, the 21 low-income housing units involved in this case may not be freely sold and there is no market for an individually owned low income rental apartment. JA at 170.

Also, in contrast to the owner in *Orchard Glen East* who elected to rent and not sell its condominium units, TB Venture is obligated by the Site Plan and the CBU Agreement to rent the 21 units at issue here for 40 years. Apparently in recognition of this fact, the Assessor's Office classifies each of the 21 units as a "642-Community Benefit Unit," not a "condominium" unit, on the Property Information Sheets maintained by the County Assessor's office. JA at 372-414.

Much of the difficulty in this case may stem from the origins of the CBU agreement. As noted above, the CBU agreement was entered into by the original developer of the Odyssey, who at that time intended to develop the project's residential units as rental apartments. Thus, the terms of the CBU Agreement were written for apartments and not for condominiums. For instance, the first recital paragraph states that the land is "... improved or to be improved by a multi-family apartment complex. . . ." JA at 290, ¶ R-1. The agreement does not identify specific units as CBUs, leaving the owner

of the apartment complex with the flexibility to designate units as necessary or available so long as they met the definitional requirements (townhouse or flat; two bedrooms or three bedrooms). Paragraph 5 of the Agreement allows the owner to permit a tenant whose income no longer qualifies him to live in a CBU to remain in that tenant's existing apartment so long as the Owner substitutes an additional unit for a qualifying tenant, thereby maintaining a total of 21 units available to eligible tenants. JA at 292.

The agreement requires the Owner to maintain 21 units for 40 years and, while binding on successors and assigns, has no provision addressing the sale or transfer of any or all the 21 units. Again, recognizing that this was written presuming these 21 townhouses and apartments would be in a 274 residential unit complex, it was contemplated that the Owner of the 21 CBU apartments would also be the owner of the complex.

The General Assembly specifically recognized that rental units limited by affordable low income governmentally imposed housing programs carry limitations which significantly affect their fair market value. Va. Code § 58.1-3295, addresses factors to be considered in determining the assessment "of real property containing more than four residential units operated in whole or in part as affordable rental housing…." Under the statute, the assessor must consider the rent and the impact of the applicable rent restrictions, the

operating expenses and the impact of additional expenses or expenditures, and restrictions on the transfer of title or restraints of the alienation of the property. Section 58.1-3295(A)(1)-(3). It is clear that these provisions would have applied under the original plan that all of the residential space in the Odyssey would have been rental. The County asserts that the intervening change from apartment units to condominium units results in the assessor no longer having to consider those factors as they affect the fair market value of these units. The County is incorrect. These constraints are every bit as real when applied to condominiums as they would have been had they been applied to apartments.

Even if *arguendo* the terms of the statute do not mandate that the assessor consider those factors set forth in subsection A, this Court has repeatedly ruled that everything that affects value must be considered. The record is clear that the low income housing restrictions imposed here affect the fair market value of these units as condominiums every bit as much as if they were still rental apartments. Yet, the County asserts that these same restrictions, which it must consider when applied to rental apartments, are, when applied to condominium units, artificial and voluntary.

Since the trial of this case, Section 58.1-3295 has been amended by adding a new subsection D (to be effective for tax years beginning January

1, 2011). This amendment dispenses with many of the issues raised by the County. Under the new statute, the assessment of qualifying property:

> . . . shall be assessed using the income approach based on: the property's current use, income restrictions, provisions of any arms length contract including but not limited to, restrictions on transfer of title or other restraints on alienation of the real property, the requirements of subsection B [which excludes federal and state tax credits for affordable housing from the real property or income attributable to the property], and all other provisions of this section.

As of January 1, 2011, low income rental apartments must be valued using the income approach and factoring in the current use (affordable housing), income restrictions, operating expenses, arms length contractual limitations including but not limited to restrictions on the transfer of title or restraints on alienation, and the other factors set forth in Section 58.1-3295.

The County asserts that, to assess the fee simple estate of these 21 condominium units, they must be valued as if they are unrestricted and not subject to the CBU Agreement's constraints. The County dismisses the impact of the income restrictions and duration of the agreement by asserting that they reflect artificial rents and voluntary constraints. Section 58.1-3295, particularly as now amended, rebuts those claims. The statute, in effect, codifies this Court's body of work concerning valuation for real estate tax assessment purposes and then applies it specifically to the assessment of low income affordable rental housing. Those factors which

the County attributes as being artificial and voluntary, the Code now requires to be considered. The valuation methodology that the County dismisses as a "leased fee," as of January 1, 2011, must be used to assess such property. If those factors are not artificial and voluntary in the context of mandatory consideration in 2011, they cannot be so artificial and voluntary that they may be disregarded with impunity when applied to these 21 commonly located condominium units in 2007 and 2008.

Virginia Code § 55-79.42 provides that each condominium unit "consists for all purposes a separate parcel of real estate." It further provides that, "If there is any unit owner other than the declarant, each unit... shall be separately assessed and taxed." While recognizing that each condominium unit is a separate parcel and should be treated as such, nothing in the statute alters or modifies the Constitutional standard limiting the assessment of property at no more than its fair market value.

Mr. Shields allocated value among the units *pro rata* based on income, because income is the only distinguishing feature that separates these units. By the terms of the CBU Agreement, location within the complex, the amenities offered, and even the views are all irrelevant. An examination of Plaintiff's Exhibit 9 (JA at 419) with respect to 2008 values

reveals only 4 different values among the 21 units, because there are only four income combinations – they range from a low of $80,398 for a condominium flat tenant with 50% of the medium income to a high of $110,354 for a townhouse tenant with 60% of the medium income. Since Income is the driving force behind these valuations, an allocation based on income fulfills the statutory mandate.

V. THE COUNTY WRONGFULLY APPLIED A COUNTYWIDE EXPENSE TO INCOME RATIO, THERBY DISTORTING THE PROPERTIES' VALUES. (AOE 3)

The BOE reduced the 2007 assessment on the units and did so using a direct capitalization methodology. The BOE correctly used the actual rents obtained by the units. However, rather than using the actual expenses provided or the actual ratio of expense to income derived from those numbers, the BOE used the County's 2007 apartment guideline expense ratios for a high-rise building, which equaled 25% of income. The BOE also used a capitalization rate from the apartment guidelines of 6%. Having found the total value for 21 Units, the BOE allocated that value among all 21 Units to obtain an assessed value for each tax parcel. JA at 105-110, 365-415 (Plaintiff's Exhibit No. 7).

The use of countywide expense ratio guidelines to determine the net income in a direct capitalization method of valuation constitutes manifest

error. In *Smith*, where Fairfax County used the same methodology, this Court noted:

> As the taxpayers point out, the County's use of a theoretical expense ratio has a distorting effect on appraised values. Rents vary widely with location, physical condition and other individual characteristics governing the relative desirability of competing rental properties. Maintenance costs, however, are nearly uniform. Thus, a building with a lower rental income would be unfairly penalized by the use of a county-wide "expense ratio."

234 Va. at 257, 361 S.E.2d at 355. That is exactly what happened in the instant case; the BOE used an expense ratio per the County guidelines of 25% (JA at 366); however, the before-tax expense ratio for the subject properties in 2007 was actually 39%. JA at 172. Similarly, the use of a 6% apartment guideline capitalization rate, not adjusted for affordable housing units, also unfairly penalizes those units which are part of an affordable housing program and constitutes manifest error.

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

William F. Krebs, Esquire, VSB 17347
Jonathan C. Kinney, Esquire, VSB 12016
Leo S. Fisher, Esquire, VSB 20957
BEAN, KINNEY & KORMAN, P.C.
2300 Wilson Blvd., 7th Floor
Arlington, Virginia 22201
Telephone: (703) 525-4000
Facsimile: (703) 525-2207
E-mail: wkrebs@beankinney.com
Counsel for Appellant TB Venture, LLC

CERTIFICATE

I, William F. Krebs, do herby certify that, pursuant to Rule 5:26(d), fifteen bound copies and one electronic copy on CD of this Brief of Appellant and Appendix 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 Appelle, this 5th day of May, 2010:

Ara L. Tramblian (VSB No. 24350)
ARLINGTON COUNTY ATTORNEY'S OFFICE
2100 Clarendon Boulevard, Suite 403
Arlington, Virginia 22201
(703) 228-3100 (Telephone)
(703) 228-7106 (Facsimile)
atramblian@arlingtonva.us

Counsel for Appellee

Counsel for Appellant respectfully requests oral argument.

William F. Krebs, Esquire, VSB 17347
Jonathan C. Kinney, Esquire, VSB 12016
Leo S. Fisher, Esquire, VSB 20957
BEAN, KINNEY & KORMAN, P.C.
2300 Wilson Blvd., 7th Floor
Arlington, Virginia 22201
Telephone: (703) 525-4000
Facsimile: (703) 525-2207
E-mail: wkrebs@beankinney.com
Counsel for Appellant TB Venture, LLC