ERP OPERATING LTD. PTNSHP.	*	IN THE
vs.	*	MARYLAND TAX COURT
SUPERVISOR OF ASSESSMENTS OF FREDERICK COUNTY	*	No. 00-RP-**FR**-0464 (1-64)
	*	

MEMORANDUM AND ORDER

Petitioner, ERP Operating Limited Partnership (ERP), has appealed the assessment of 64 two story, no basement townhouse residences located within the city limits of Frederick, Maryland. The property, known as Overlook Manor III Apartments, is part of the larger Frederick Heights community. Although the 64 units were purchased in bulk in 1998, each of the 64 townhouses is platted as an individual fee simple townhouse lot. The current State assessment values each interior or center unit at $81,000 per unit, and each end unit at $86,040 per unit. The main issues presented by this appeal are what is the highest and best use of the subject properties, and given that usage, what is the correct property valuation for tax assessment purposes.

Petitioner testified that these properties were purchased on July 15, 1998, from Tillman Place Limited Partnership (Tillman). Prior to, and up until the time of purchase, a HUD mortgage held by Tillman securing the properties contained a restriction requiring that the properties be held as rental units and not be offered for individual sale. When ERP bought the properties, the HUD mortgage was paid off, thereby removing any further restriction on sales. ERP asserted, however, that they have always intended to continue the units as rental properties, and that at no time has there been any plan to convert them or to offer them for sale as owner occupied dwellings. Mr. David Ohlrich, Vice President, Asset Management, for Equity Residential, the parent company, further testified that his firm operates thousands of rental units throughout the United States and is not in the business of offering their properties for sale to owner occupants anywhere in the country.

Petitioner called Mr. Ryland L. Mitchell as their real estate expert. Mr. Mitchell offered his appraisal of the property and testified as to his opinion of its highest and best. Citing several factors, Mr. Mitchell concluded from his appraisal that the highest and best use of these properties would be to continue them as rental units. Accordingly, he valued the property consistent with its ongoing operation as a rental apartment community. Factors cited in support of his conclusions included, *inter alia*:

In Mr. Mitchell's experience, most owner occupied townhouses have basements and the subject properties do not, thereby making them less attractive as owner occupied dwellings.

The sales experience of the Providence community, a nearby development of mixed rentals and owner occupied townhouses, had not been good in that there had been numerous foreclosures due to 100 % government financing to purchasers with questionable financial resources. Although there were separate water meters in each unit, the County provided single water billing to ERP and had refused to render individual bills.

The properties had been successfully operated as rental units since inception and there was no reason or justification to change their valuation simply due to a change in ownership.

Mr. Mitchell concluded his appraisal by stating that the total property value was $4,500,000. He testified that he had reached this conclusion using both a sales comparison and income approach, and then correlating the two. This valuation is in contrast to the current State assessment total of $5,274,720. In his market approach valuation, Mr. Mitchell began by developing an estimate of each unit's value to an individual owner, and then deducted from this estimate certain costs he considered appropriate to convert a typical unit from bulk rental to individual ownership. Mr. Mitchell used recent sales of townhouse units from the Providence community for his sales comparisons.

The State took issue with Mr. Mitchell's valuation methodology contending that it represented a "Developmental Approach" similar to what a developer or investor would use, rather than using the more traditional sales comparisons of similar properties. By deducting costs and expenses from an established market value, the valuation spoke more to investment risk and rate of return than to normal market value. Thus, the State contended that, although a developmental approach might serve an investor or developer well, in their view it was inappropriate for residential townhouse market valuation. In support of its own valuation, the State Assessor presented the State's traditional method of comparing recent sales of properties that are similar to the subject. Interestingly, the State also used the Providence townhouse community from which to draw its comparable sales.

It is significant that both Petitioner and Respondent used the Providence townhouse community from which to draw their comparable property sales. It is also significant that both sides established a preliminary market valuation for each unit that was essentially the same, namely in the $80,000 price range. The two sides diverged in their final market valuation by virtue of Mr. Mitchell's additional step of deducting development costs from his preliminary market valuation. Both sides cited selected case law and statutes in support of their position.

Petitioner, through his expert, also asserted that converting the subject properties from rentals to owner occupancy would not be financially viable. To support this contention, the expert cited the fact that several conversions in the nearby Providence community were financed at 100 % by the FHA, and had gone to foreclosure after being converted to owner occupancy. The implication of this testimony was that purchasers who received 100 % financing had little personal investment in each unit, were generally of questionable financial means, and were therefore more likely to default on their loans. This formed a basis for his conclusion that, in the expert's opinion, conversion from rentals was financially risky and therefore not the highest and best use.

The Court rejects this interpretation of financial viability. In describing the Providence community there was testimony from both sides citing examples of properties, similar to the subject, which had been converted successfully to owner occupied dwellings. The evidence established that there were 51 units in Providence, of which approximately **2** were rentals and **2** were owner occupied. There were 19 units owned by three investment groups. Thus, there were numerous successful examples of owner occupancy of townhouse units in the immediate Frederick Heights area. The fact that some units underwent foreclosure speaks more to the financial stability of individual borrowers rather than to the viability of a unit as an owner occupied dwelling. Certainly, many financial and economic factors influence one's ability to continue mortgage payments, regardless of one's station in life. Failure to do so does not negate the appropriateness of the mortgage itself, or automatically negate the highest and best use of the property that secures it.

It should be noted that, until Petitioner purchased the property, an existing mortgage required that the property continue as a rental community. This impediment to owner occupancy was erased, however, when the then existing HUD mortgage was paid off. With no restriction on sale, Petitioner was free to offer the properties for sale to owner occupants, or to continue renting them as he saw fit. His choice to continue them as rentals, however, does not automatically dictate that this is the highest and best use available. The highest and best use is not necessarily the current use. This principle is well established by the many examples which have come before the Court where, for many and sundry reasons, a property was not currently being used up to its fullest potential.

The Court rejects the argument that continued use as a rental community, in and of itself, establishes rental as the highest and best use. It also finds no merit in the contention that townhouses without basements are inappropriate or less desirable as owner occupied dwellings. There are many examples of homes of all types without basements, including the State=s comparable sales examples in this appeal. Accordingly, this aspect of Petitioner's justification of continued rental valuation is unpersuasive and is rejected.

After carefully listening to the testimony and reviewing all the documentary evidence, including the cited cases and statutes, the Court finds that the highest and best use of each townhouse unit to be owner occupied residential property.

Having found that the highest and best use of the 64 townhouse units is as owner occupied properties, the Court finds that Petitioner's approach to valuation is inappropriate. Petitioner=s deductions of development costs and expenses are more suited for a developer=s analysis of income potential and risk. The more appropriate valuation technique in this case is to analyze sales, in the requisite timeframe, of similar properties which reflect an arms length transaction between a willing buyer and a willing seller. The State used such sales in supporting their valuation, and the Court finds that their evidence is sufficient to sustain their assessment. The Petitioner, having failed to meet his burden of persuasion, fails in his assertion that the State's valuation methodology and resultant assessment is incorrect.

Accordingly, it is this **4th** day of **April, 2001**, by the Maryland Tax Court ORDERED that the decision of the Property Tax Assessment Appeals Board for Frederick County be and the same is hereby AFFIRMED for the tax year 2000.

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Judges