PARK CIRCLE EQUITIES	*	IN THE
	*	
v.		MARYLAND TAX COURT
	*	
SUPERVISOR OF ASSESSMENTS OF ANNE ARUNDEL COUNTY	*	No. 14-RP-AA-0253 No 14-RP-AA-0254
	*	

MEMORANDUM AND ORDER

This case arises from a dispute between the Supervisor of Assessments for Anne Arundel County ("Supervisor") and Park Circle Equities ("Taxpayer") regarding the valuation for tax years 2011 and 2013 of an office building titled to the Taxpayer ("building"). The Supervisor argues for $5,884,100 and $5,006,700 valuations for tax years 2011 and 2013, respectively, consistent with the valuations set by the Property Tax Assessment Appeal Board, while the Taxpayer argues for valuations of $3.2 million and $3 million for those two tax years, respectively. The dates of finality for the 2011 and 2013 tax years, upon which the focus is for valuation, are January 1, 2011 and January 1, 2013, respectively.

The Taxpayer offered testimony from David H. Brooks, an expert in real estate valuation, and William Barroll, a Senior Vice President with Corporate Office Properties Trust, the real estate investment trust that owns the building. Mr. Barroll testified he was familiar with the building as it was his "...job to make sure it was full." The Supervisor offered testimony from Braxton McNeil, a commercial real estate valuation expert employed by the Supervisor. There was no dispute regarding the experts' credentials to offer an opinion regarding the valuation of the building.

The building has 59,171 square feet of rentable area[1] and is located at 7272 Park Circle Drive, Hanover, Maryland. Respondent's Exhibits 1 & 2, pp. 1. Mr. Brooks observed its location is advantageous due to "...military base alignment and NSA growth ...increase[ing] demand for office space in this area," with Mr. Brooks further noting that "...the excellent road network and proximity to the Baltimore Washington International Airport are considered positive features in attracting tenants to the area." Petitioner's Exhibits 1 & 2, pp. 11 & 14 and 15 & 21, respectively. Mr. Barroll cited demand from "...a very specific user that needs high-end secure space for their work," known as a Sensitive Compartmental Information Facility or SCIF. Referencing a "deal," he suggested the increased build-out cost to accommodate this use is offset with a "bit longer term." Mr. Brooks highlighted a lease to CACI Technologies Inc. with a term of 10 years, 9 months as a SCIF, suggesting, as did Mr. Barroll, that the increased SCIF build-out cost leads to longer leases.[2]

Mr. Brooks premised his valuation determinations on a discounted cash flow (DCF) analysis. Petitioner's Exhibits 1 & 2, pp. 57 & 58, respectively. The Court will not rely on this analysis for two reasons.

First, a DCF analysis requires the quantification of multiple assumptions, which Mr. Brooks testified are input into a software program known as ARGUS. See Petitioner's Exhibits 1 & 2, pp. 96 & 95, respectively. Mr. Brooks found the

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[1] While Mr. Brooks reported a modestly higher rentable area, the Court chooses to rely on the lower area reported by Supervisor. Petitioner's Exhibits 1 & 2, p. 1.

[2] Referring to that lease, Mr. Brooks testified that "...with that money [for the increased build-out]" the tenant "...will stay."

"frequently" used and less prolix direct capitalization valuation methodology, upon which the Supervisor relied, inappropriate as the building suffered from "...excess vacancy.." leading to "...disparate incomes." While the building was burdened with vacancy rates in excess of the market before both dates of finality, the Court finds the excess and varied vacancy rate upon which the use of the DCF analysis was justified self-imposed and that the excess vacancy would be viewed as rectifiable through appropriate improvements. The taxpayer's evidence supports this finding.

Mr. Brooks testfied the building "...required continual upgrading just to keep tenants in it." He reported this "inferior" condition being reflected in an "...at or above 20%.." vacancy rate. Petitioner's Exhibits 1 & 2, pp. 24 & 26, respectively. Mr. Barroll testified capital investment was implemented to "...make it [the building] shine so we could attract new tenants." Confidence in this result is documented in Mr. Brook's projecting a normalized 15 percent vacancy rate, which is well below the 20 percent vacancy rate he testified was the historic lowest rate.[3] Petitioner's Exhibits 1 & 2, pp. 24 & 29, respectively. So, the Court concludes the premise for rejecting a direct capitalization based valuation is flawed, as a stable and much improved future vacancy rate would obviously be achievable.

Second, Mr. Brooks identifies 10 cash flow assumptions which he testified that "[f]or the analysis to be credible [would] have to have a likelihood of occurring as projected." Petitioner's Exhibits 1 & 2, pp. 60-61 & 61-62, respectively. The Court adds to those assumptions needing a "likelihood of occurring as projected" the

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[3] The Supervisor also projected a 15 percent normalized vacancy rate which may be conservative as before the Great Recession the vacancy rate in the submarket reached below eight percent. Petitioner's Exhibits 1 & 2, pp. 23 & 25, respectively.

chosen 10-year holding period and the 5-year term for every new lease. Petitioner's Exhibits 1 & 2, pp. 52 & 53, respectively. The holding period length directly impacts the compounding effect of an error in an assumption, with Mr. Brooks reporting that the length of a holding period "..may vary.... depending on the specific circumstances of each analysis." Petitioner's Exhibits 1 & 2, pp. 43 & 57 and 45 & 58, respectively. Mr. Brooks highlighted the import of the assumed lease term by testifying that at its conclusion every five years the Taxpayer would be "...up at bat again."

This assumed five year lease term is of greatest concern to the Court as it permeates the magnitude of many of the assumptions' impacts, including those for market rent; rollover vacancy and renewal probability; tenant improvements; and leasing commissions. The Court finds that the five year lease term is understated since, as noted previously, with the needed improvements to the building there will be a greater allure for SCIFF tenants, whose lease term will be greater than five years. Not accommodating this reality, along with the uncertainty inherent in the other projections over a 10-year period, undermines the Courts confidence in the DCF analysis.

Having rejected the DCF analysis, the Court is compelled to rely on the direct capitalization valuation offered by the Mr. McNeil. That methodology requires that a capitalization rate be applied to the Net Operating Income (NOI) of the building. With insignificant or only modest disagreement between the parties' experts regarding two critical components of the NOI, the stabilized vacancy rate and the appropriate per square

foot rent[4], the Court will apply the vacancy rate and rent proposed by Mr. McNeil, accepting his NOI determinations.[5]

After applying his suggested capitalization rates to the NOI's, Mr. McNeil deducted his determined lease up costs for expiring leases. Respondent's Exhibit's 1 & 2, p. 2. He suggested this deduction also compensated for vacancy challenges, thereby eliminating the need for the capitalization rate to reflect this risk. The Court disagrees and will apply the higher capitalization rate proposed by Mr. Brooks.

While improvement to the normalized 15 percent vacancy rate is envisioned with Mr. McNeil suggesting it will be achieved "expeditiously," the risk in reaching this benchmark is not adequately reflected in the lease up cost deduction. This risk should also be considered in the capitalization rate determination, which Mr. Brooks reported should reflect risks arising from "…age, tenancy, location and physical characteristics." Petitioner's Exhibits 1 & 2, pp. 59 & 60, respectively. Considering these risks, Mr. Brooks chose a capitalization rate of 10.5 percent for both tax years, which the Court accepts.[6] Petitioner's Exhibits 1 & 2, pp. 59 & 61, respectively. Applying this capitalization rate to the NOI's proposed by Mr. McNeil with the lease up cost

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[4] Misters Brooks and McNeil based their projections on the actual reported rents for leased space and forecasted per square foot rents for the vacant space. Mr. Brooks characterized his forecasts as being "...very close to the State," i.e., Mr. McNeil's forecasts.

[5] In response to an inquiry by the Court, Mr. Brooks suggested NOI's for both tax years 2011 and 2013 of $507,226. While his response was equivocal, the Court finds these suggested NOI's sufficiently close enough to those proposed by Mr. McNeil to support the Court's acceptance of Mr. McNeil's NOI determinations.

[6] Mr. Brooks characterizes his 10.5 percent determination as "an unleveraged yield rate," which the Court views as synonymous with a capitalization rate.

deductions results in fair market valuations for tax years 2011 and 2013 of $4,814,491 and $4,164,871, respectively.

Accordingly, it is this 16th day of June, 2015, by the Maryland Tax Court **ORDERED** that the decision of the Property Tax Assessment Appeals Board for Anne Arundel County is reversed and that the fair market values for the subject property for tax years 2011 and 2013 are $4,814,491 and $4,164,871, respectively.[7]

cc: David B. Abramoff, Esq.
David M. Lyon, Esq.
Kent Finkelsen, Administrator

CERTIFIED TRUE COPY
TEST: John T. Hearn, Clerk

NOTICE: You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review **MUST** be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.

[7] Issues raised and differences in the experts analysis not specifically addressed by the Court were deemed de minimis.