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December 24, 2003

VIA FACSIMILE

J. David Leslie, Esq.
Rackemann, Sawyer & Brewster
One Financial Center
Boston, MA 02111

Re: *Home Insurance Company - Proposed Settlement of Tax Certiorari Proceedings 59 Maiden Lane, New York, New York*

Dear Mr. Leslie:

As you know, we represent HSBC Bank USA ("HSBC"), as Indenture Trustee, for the holders (the "Noteholders") of the 10 3/8% Secured Notes due 1995 of Olympia & York Maiden Lane Finance Corp. ("O&Y") issued pursuant to the Indenture, dated as of December 23, 1985, between O&Y and HSBC, as successor Indenture Trustee.

We are in receipt of Nathan Aber's December 11, 2003 letter to you in which he states that the proposed settlement (as described in your December 3, 2003 letter to Mr. Aber) negatively impacts upon Amtrust's years of ownership of 59 Maiden Lane. The proposed settlement, similarly, negatively impacts the Noteholders' rights pursuant to the Settlement Agreement, dated December 22, 1997, among HSBC, the Home Insurance Company, Olympia & York Maiden Lane Company, LLC and Risk Enterprise Management Limited.

Accordingly, HSBC fully supports the views expressed by Mr. Aber in his December 11 letter.

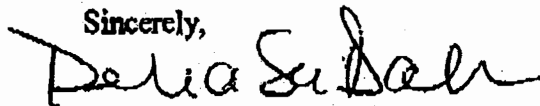
NY01/SUDOD/890177.1

J. David Leslie, Esq.
December 24, 2003
Page Two

We look forward to working with you and Mr. Aber in resolving this matter.

Best wishes for a happy Holiday season.

Sincerely,



Debra SuDock

cc: Mr. Nathan Aber
Mr. Moses Marx
David E. Retter, Esq.

DEC-26-2003 10:09 AMTRUST REALTY CORP 212 619 6933 P.03/03

1984/85 through 1989/90, unanimously affirmed, without costs.

[1] After a hearing at which expert testimony was presented by appraisers for both parties as well as experts on the costs of asbestos removal, the court, in a lengthy and well-reasoned decision, reduced the assessments for the six years under review by 39% from $951 million to $581,634,000, entitling petitioners to a tax refund of $23,-721,371, plus interest. The court credited petitioners' testimony that there were significant physical and functional impairments throughout the building as a result of the presence of asbestos; rejected respondents' appraisal as designed to minimize expenses and maximize income; rejected the value conclusions of petitioners' method of income capitalization; performed analyses of the existing data to demonstrate overassessment; and utilizing a 1983/84 assessment as a benchmark for value, equalized the value to correct the assessments for the years under review.

[2] The presumption of validity of an assessment by the taxing authority is rebutted where, as here, credible evidence to the contrary is received (*Mobil Oil Corp. v. Tax Commission of the City of New York,* 60 A.D.2d 910, 911, 401 N.Y.S.2d 565). The court could properly reject both petitioners' income capitalization approach and respondents' reproduction cost approach, and instead arrive at a value based on an analysis of both approaches that emphasized a pragmatic adjustment to the economic realities of the particular building (*see, G.R.F., Inc. v. Board of Assessors of the County of Nassau,* 41 N.Y.2d 512, 514–515, 393 N.Y.S.2d 965, 362 N.E.2d 597). The values reached were within the range of evidence produced at trial (*Matter of Katz v. Assessor of Village/Town of Mount Kisco,* 82 A.D.2d 654, 659–660, 442 N.Y.S.2d 795). Nor was it improper for the court to consider the foreseeable cost of curing the building's deficiencies, particularly with respect to asbestos contamination and physical and functional obsolescence (*see, Matter of Northville Industries Corp. v. Board of Assessors of the Town of Riverhead,* 143 A.D.2d 135, 531 N.Y.S.2d 592).

179 A.D.2d 389

In the Matter of the Application of WOLF POPPER ROSS WOLF & JONES, Applicant–Respondent,

To take the Deposition of HRE Properties, Inc., Objectant–Appellant,

Pursuant to CPLR 3102(e) etc.

Supreme Court, Appellate Division, First Department.

Jan. 9, 1992.

Former minority shareholders challenged fairness of cash-out merger. The Supreme Court, New York County, Fingerhood, J., denied motion to quash plaintiffs' subpoena duces tecum, and appeal was taken. The Supreme Court, Appellate Division, held that shareholders were entitled to discover documents concerning value of corporation's major asset.

Affirmed as modified.

1. Corporations ⚷584

Under Delaware law, value of shareholder's interest is to be determined, for purpose of determining fairness of cash-out merger, by consideration of various factors, including asset value, earning prospects and facts known or ascertainable at time of merger that shed light on future prospects of corporation; nonparty corporations may be subject to disclosure concerning value if reasonable and necessary.

2. Corporations ⚷584

Minority shareholders challenging fairness of cash-out merger were entitled to disclosure concerning nonparty corporation's value as of time of merger; more

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 24

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In the Matter of SANDRA BASS, JOHN P. McGRATH and ARTHUR ROTH as Executors U/L/W/T of SOL G. ATLAS, Deceased and JOHN P. McGRATH and NEW YORK PLAZA BUILDING CO.,

Petitioners,

Index Nos. 56969/84 56418/85 57750/86

-against-

THE TAX COMMISSION OF THE CITY OF NEW YORK & THE COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

---X

In the Matter of SANDRA BASS, JOHN P. McGRATH and ROBERT ZABELLE as Executors U/L/W/T of SOL G. ATLAS, Deceased and JOHN P. McGRATH (1) and NEW YORK PLAZA CO. (2)

Petitioners,

Index Nos. 56435/87 57371/88

-against-

THE TAX COMMISSION OF THE CITY OF NEW YORK and THE COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

---X

In the Matter of SANDRA BASS and ROBERT ZABELLE as Executors U/L/W/T of SOL G. ATLAS, Deceased, and LUCY FLEMMING McGRATH as Executrix U/L/W/T of JOHN P. McGRATH (1) and NEW YORK PLAZA BUILDING CO.(2),

Petitioners,

Index No. 58847/89

-against-

THE TAX COMMISSION OF THE CITY OF NEW YORK and THE COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

---X

PARNESS. J.

This consolidated tax certiorari proceeding reviews six years of assessments, 1984/85 through 1989/90 on One New York Plaza, Block 4 Lot 1, a 50 story centrally air conditioned 2,251,789 rentable square foot circa 1970 office building. The improvement occupies a 110,356 square foot lot, an entire city block, bounded by Water, Broad, Whitehall and South Streets.

The assessment ratio for each year having been stipulated, the sole issue for the court is the full market value of the subject property for the tax years in question.

The actual and resulting transitional assessments being challenged are as follows for the tax years indicated:

YEAR	ACTUAL	TRANSITIONAL
1984/85	$145,000,000	$ 99,000,000
1985/86	153,000,000	112,600,000
1986/87	153,000,000	126,200,000
1987/88	160,000,000	141,200,000
1988/89	170,000,000	151,200,000
1989/90	170,000,000	161,200,000

Applying the stipulated ratios the following would be the market value for the subject premises said assessments would

represent:

1984/85	$315,217,000
1985/86	306,000,000
1986/87	283,333,000
1987/88	266,667,000
1988/89	369,565,000
1989/90	386,364,000

Petitioner-owner asserts lower values and respondent-city higher ones as follows:

YEAR	PETITIONER	RESPONDENT
1984/85	$ 90,900,000	$382,430,000
1985/86	82,900,000	372,880,000
1986/87	109,000,000	394,140,000
1987/88	136,700,000	373,900,000
1988/89	153,100,000	410,250,000
1989/90	156,400,000	469,570,000

On the cumulative six year actual assessment of $951,000,000 petitioner paid real estate taxes totaling approximately $65,021,417. A $951,000,000 assessment based upon the stipulated ratios indicates a cumulative market value of about $1,928,000,000.

According to petitioner's expert the six year cumulative market value of this property is $729,000,000. Based upon the

agreed ratios the Cumulative tax assessment computed on petitioner's value would then come to $363,386,000 (38.2% of the actual cumulative $951,000,000 assessment.) Upon these computations petitioner seeks a refund in excess of $31,000,000.

A special circumstance gives rise to the inordinate dispute concerning the value of this property.

It was established at trial to the court's satisfaction that the property has significant physical and functional impairment which impact upon its market value. Neither the tax assessor or respondent's appraiser have apparently given any significant consideration to these building deficits in determining value. The problem of first magnitude is the existence of asbestos throughout the building. Asbestos permeates the structure. During construction of the building, the frame, the steel beams and underside of the decks, (the floor pans), were coated with asbestos fire-retardation material. Asbestos was liberally used to insulate pipe fittings, pipe joints and mechanical equipment throughout the building. The building's central core, containing the elevator shafts, ventilating, piping and wiring is impregnated with asbestos. In 1989 two elevators were non-operating because mechanics refused to enter the shafts due to the presence of asbestos (Tr 152). Thirty foot walls in the fan room on the 18th and 19th floors are coated with unshielded as-

bestos (Tr 154). Delamination, (asbestos flaking) is observed in some areas above the ceiling tiles, where the wiring for electricity, telephones and computers is located. Telephone workers and electricians have refused to work in certain areas (Tr 154). The largest air conditioning fans ever built for office building use are on the 18th and 19th floors. The vibration and force of these fans have caused the walls on the 18th and 19th floors to buckle requiring interior reinforcement. Because of the vibration there is a potential for asbestos proliferation through the ventilation system. (Tr 138). The operating problems that arise because of this presence of asbestos are many: significant plumbing, telephone, electrical and other equipment is located in the building ceilings. Whenever a ceiling is opened to install or repair such items the asbestos exposed and/or disturbed thereby requires the presence of a standby containment crew.(Tr. 151) Tenant renovations or alterations (work letters) would also implicate asbestos abatement. In one instance to correct and repair a sewer trap located above the lobby (a plumbing expense of $3,000), an additional $100,000 had to be spent for asbestos removal to make the work area above the ceiling safe. This operation also required temporarily cordoning the lobby. (Tr. 152)

Petitioner's asbestos expert Donald Weekes estimated the

1984/85 cost of building-wide asbestos abatement at $81,892,800 and observed abatement costs increase with time (tr 58-60). It was the witness' expert opinion that eventually all asbestos should be removed. The court finds this to be a reasonable conclusion. He testified that as of 1984 insurance companies were not writing coverage for pollution (asbestos) liability (Aetna, Travelers, Connecticut Mutual and Home Insurance Companies had a policy of not insuring against pollution); that insurance companies have been unwilling to provide coverage for mortgages on properties that have this problem (Tr 79) and that a building with asbestos is considered"structurally damaged" (Tr 107). There is no testimony to contradict a conclusion that a prudent owner would undertake to remove the asbestos as soon as space became available.

Bernard Hartman, building manager testified that, aside from asbestos, major design flaws in the building have resulted in foundation, roofing, and window problems. Rain and river water seep into the second basement, where water penetrates cement and inundates electrical conduits. The building's roof, not having a parapet wall, is constantly damaged when buffered by high winds. The defects extend to the 3,200 windows that require constant care and maintenance (Tr 143). Finally, thousands of thermostat controls are located unfortunately within the hung

ceilings of the building which when accessed require dealing with the asbestos condition.

Sidney Barbanol the licensed professional consulting engineer who designed the mechanical and electrical systems in this building, testified that the cost to cure the substantial deficits in the building which also include those in the electrical, heating, air-conditioning, air distribution systems, elevators and flood gates would in 1989 prices cost $51,595,500. The cost in 1984 prices was about $40,081,690.

There is nothing in this record to question the need for these repairs or their cost. In sum, the total estimated cost to abate asbestos and to cure the mechanical and physical problems based on 1984 figures according to these witnesses was $121,974,490 ($81,892,800 asbestos, $40,081,690 mechanical/physical). The cost to cure increases with delay.

It is clear that the cash flow of this property has been and continues to be insufficient to fund a repair and abatement program and still provide a return on investment.

The respondent offered the testimony of Richard Miller, a consulting engineer and certified asbestos investigator who said on each the floors that he inspected there was fireproofing material (asbestos) on the beams; there was some slight delamination (Tr 712); that he would not, on the basis of his

examination, presently recommend immediate evacuation of the building (Tr 714). (No one suggested this!). However, he would advise an immediate comprehensive survey that would entail the preparation of an operation and maintenance program for the building; the survey would also provide both short term and long term recommendations and abatement measures as may be necessary. In order to ascertain the levels [of asbestos pollution] within the building, he recommended testing by microscopy contrast and electric miscroscopy. Mr. Miller's survey and recommendations would cost between $120,000 and $180,000 (1990). Baseline testing according to the witness, would cost approximately $89,000 (1990) and, on going six month surveys thereafter $31,600 (1990). On the basis of the survey, respondents' witness would where indicated recommend "immediate abatement" of those areas deemed severely damaged or presenting an immediate potential hazzard to building occupants." His long range recommendations might include performing asbestos abatement at termination of leases or in conjunction with planned renovation of tenant spaces (the very same program anticipated by the petitioner's expert in arriving at his appraised value [respondent's exhibit B 1 in evidence the asbestos appraisal]).

To the extent this witness inspected the building, his examination confirmed that the ceilings and beams are coated with

asbestos.

Though respondent acknowledges the need to constantly monitor the asbestos problem, respondent's appraiser fails to take into account the effect on market value of the presence of asbestos and direct and indirect costs for its removal.

What major tenant would take a lease in a property at market rental knowing that air must constantly be tested for dangerous asbestos with millions of square feet of prime alternative space available without this problem? It is respondent's own witness who reports that epidemiologicol data indicates exposure can be linked to asbestos, lung cancer and mesothelioma (exhibit B1 in evidence).

Respondent points out that some space in this building was leased during the years under review. However, these leases were to existing (captive) tenants for additional space in the building. A convenience which may not necessarily reflect true "market" transactions. The court, further, notes some of that space was leased "as is " avoiding the need for alterations, that might disturb the asbestos. In one instance the rent to a present tenant was at below market. Of greater significance is the fact that a long term major tenant, Salomon Brothers, who had the right to extend its lease, vacated the building. It is significant that this tenant choose not to exercise an option to

continue occupancy or to sublease at a profit, if indeed, it is correct that the Salomon lease was below market rent. The tenant's failure to renew might well indicate either a desire to be free of the problem or that there was no subletting market for the space sufficient to warrant the retention of the lease.

Respondent's real estate witness reports to have valued this property on the basis of fair market rentals received by five "comparable" properties. On cross-examination it turned out the "comparables" buildings either never had an asbestos problem or the problem was corrected. The so called comparables are clearly not comparable. One of them, 125 Broad Street for example, was purchased by Olympia York and vacated by its major tenant American Express. It took the new owner almost two years to abate the asbestos problem and refurbish the building before the building could be relet. Obviously it is easier and less costly to correct asbestos problems in vacant space.

Finally respondent's own appraiser, Simms, reluctantly conceded that no major institutional tenant, the type this building was built for and would attract, would rent space at market rents unless the asbestos were first removed. (Tr P. 848-849).

Aside from the failure of respondent's expert to consider seriously the effect of the presence of asbestos and other building problems upon market value, the disparity in the respective

experts' market value evaluations was further magnified by the differences in the assumptions made with respect to income and expenses and methodology employed.

The test to determine market value for tax purposes is the price at which the property would sell under ordinary circumstances. (People Ex Rel Parlin v Miller 287 N Y 126, 129).

> "Although the most accurate standard is provided by the sales price of comparable properties located within the same or similar competitive area. . . . in th absence of sufficiently reliable market data, alternative methods such as income capitalization . . . maybe employed".

People Ex Rel Gale v Tax Commission 17 A D 2d 225, 227.

In fact, with respect to income producing property, such as office buildings, income capitalization is the preferred method, (Kew Gardens Assoc v Tyburski 70 N Y 2d 325, 331).

Mr. Simm's appraisal submitted in evidence, uses basic direct capitalization as the method to compute value. By this method, Simms computes the sum that an investor would pay for the right to receive the net income from the building. This method assumes that the investor will base his decision on the net income in the year of the sale alone. The sale price would be equal to a sum that would be discounted by the net income produced on the building in the year of sale at a rate of discount competitive with other investment alternatives in the same

year.

For all of the years in review, Simms concludes that a fair average rate of capital return would be 10.17% on the building and 8.0% on the land. This "split capitalization" rate is based on the assumption that the building depreciates while the land does not (Simms appraisal, p. 17). The capitalization rate advocated by Simms is based on computing an average yield on low risk investments.

He finds an average investment yield of 9.63% which is then adjusted upward by factor of .70 (+.70) for the lack of liquidity of real estate as opposed to competitive investments. It is further adjusted downward for the expected appreciation of the real property, relatively unaffected by erosion from inflation, and the tax advantages afforded by building depreciation allowances (Simms' appraisal, p. 17). The overall yield is a rate "split" between the land and the building as set forth herein. This rate is then used to determine the market price of the property based on the expected rate of return as applied against the net income calculated by Simms for each of the years under review.

Petitioner's objection to this capitalization method is that it does not fairly account for the effect of the variables of the rental market, and the need for capital repairs over the investment life of the building. Only the income and expenses

for the particular year under review are considered. Petitioner maintains that no investor would determine to invest in the building solely on his expectation of income for the first year of ownership. Therefore, valuation requires a more accurate method of predicting the value of the property to the investor taking a longer range view of the present value of future benefits (Transcript, p. 331).

Petitioner's expert, Haims, advocates that the discounted cash flow method (DCF) of capitalizing the present value of future benefits of ownership provides such long range views. Under this method, the appraiser computes a present value for the net income which he projects will be received in each year during a cycle of years. To determine projected net income for each year of the cycle, the appraiser starting with the actual building data for the year at issue e.g.: income, expenses, lease terms, vacancy history etc. makes certain assumptions with respect to future increases or decreases based either upon the property's history or experience of the real estate market. It thus is assumed that the building will be sold at the end of that cycle, and the sale will bring a return on the capital investment of the owner. The present values of the right to derive net income from the building in each year of the cycle is totaled for the number of years in the cycle. That sum is added to the

present value of the expected capital return on the sale of the building after the completion of the cycle. The total of these two sums yields the present value of the future benefits of property ownership, which is the present market value of the building (Tr. 337). The number of years in the cycle is chosen according to how long it will take to reach the maximum net income the building is capable of producing, inasmuch as it is presumed an investor would hold the building until the year in which the best price could be obtained (Id.). With the DCF method an appraiser can take into account foreseeable or projected income and expense chargers, which may not necessarily be reflected in the building's current data but which may very well impact upon what a purchaser will pay for the property. Mr. Haims testified, unequivocally, that the discounted cash flow method "is the only method of appraisal used in multi-tenanted office buildings today." (Transcript p. 340).

The method advocated by Mr. Haims may be illustrated by the following example for the 1984/85 tax year:

Haims presumes that a purchaser of property would view its value as that of an investment, chosen for the expected rate of return on the purchase price in comparison with the return on other, competitive investments. Haims posits that A rated corporate bonds represent the most appropriate comparative invest-

ment alternatives in terms of relative risk and expected return (Haims' appraisal in evidence, (p.119). Comparing the average discounted rate of return on corporate bonds of all ratings, municipal bonds and five and ten years U.S. Bonds, Haims concludes that an investor in 1984 would expect to get 13.10% as a discounted rate of return on his investment at the end of the year (e.g. $100.00 returns $113,.10 at years end). The real estate investor would, therefore, only be willing to pay as much money as would earn him a return at that rate for the right to own the building in 1984. Based on Haims' supporting schedules and analysis (discussed in detail, *infra* - an investor could expect to derive a cash flow of $10,034,500.00. If this is discounted by the factor of 13.10% for a one year investment paying the aforesaid sum, the investor is willing to pay $8,872,200.00 for the right to obtain that return in the first year of ownership in 1984.

Similarly, the same investor, based on Haims' analysis of the buildings income and expenses. could expect to earn a cash flow of $11,092,000.00 in 1985. But now the investor has to wait that much longer (another year) to collect a return on money invested when he bought the building in 1984. Even though the net cash flow is greater than in 1984 the right to receive it is worth less to the investor in 1984 because of the longer wait to

realize the gain. Therefore, according to Haims, an investor would only be willing to pay $8,671,400.00 for the right to own the building and collect that sum in 1985. Further calculations are made, using the same method for each year of the twenty year cycle projected by Haims for this building (Haims appraisal in evidence, p.118). The total of these discounted values for the twenty-year cycle plus the present value of the right to receive a return on the capital investment upon hypothesized sale at the end of the cycle, yield the value of the property for market purposes in 1984. The present value (i.e., the value in the year under review - in this example 1984) of the expected return on the building's sale of $566,049,700 is also discounted due to the twenty-year delay in realization. (Transcript, pp. 459-460). The following chart shows how this method is used for the 1984/85 tax year.

One New York Plaza
Manhattan, New York Appraisal as of 05-Jan-84

Valuation Year	Year Starting	Cash Flow	Discount Factor @ 13.10%	Present Worth
1	Jan-84	10,034.5	0.884173	8,872.2
2	Jan-85	11,092.1	0.781762	8,671.4
3	Jan-86	11,019.7	0.691213	7,617.0
4	Jan-87	10,956.3	0.611152	6,696.0
5	Jan-88	10,891.0	0.540365	5,885.1
6	Jan-89	(7,238.5)	0.477776	(3,458.4)
7	Jan-90	6,003.6	0.422437	2,536.1
8	Jan-91	(33,090.3)	0.373507	(12,359.5)
9	Jan-92	16,146.7	0.330265	5,332.6
10	Jan-93	16,011.2	0.291994	4,675.2
11	Jan-94	10,871.4	0.258173	2,806.7
12	Jan-95	12,435.2	0.228270	2,838.6
13	Jan-96	(44,183.7)	0.201830	(8,917.6)
14	Jan-97	(121,556.9)	0.178453	(21,692.2)
15	Jan-98	48,498.1	0.157783	7,652.2
16	Jan-99	42,604.9	0.139508	5,943.7
17	Jan-2000	25,654.4	0.123349	3,164.4
18	Jan-2001	44,635.2	0.109062	4,868.0
19	Jan-2002	59,979.9	0.096430	5,783.9
20	Jan-2003	67,639.8	0.085261	5,767.0
Subtotal				42,682.2
Reversion		566,049.7	0.085261	48,262.0
Indicated Value				90,944.2

REVERSION CALCULATION

Year 2003 Net Operating Income		68,157.0
Capitalized @	11.80%	577,601.7
Sales Expense @	2.00%	11,552.0
Reversion		566,049.7

The discrepancies between the value asserted by the parties are not due solely to the differences in the methods by which the value of the cash flow—is calculated. The parties differ markedly on the assumptions each makes to produce the cash flow figures on which their respective capitalization methods are based.

Close analysis of the assumptions and methodology employed by respondent's appraiser exposes its deficiency in pointing to the true market value of this property.

Disregarding all contract rents respondent's appraiser attributes to One New York Plaza an effective cumulative gross market rent of $418,652,000for the years under review. Based upon this hypothetical rent, and using a direct split capitalization method he reports a cumulative theoretical market value of $2,403,170,000. This witness' estimated cumulative net income $346,112,000 is $51,049,000 more than One New York Plaza's actual cumulative GROSS income ($295,063,000).

Assuming a prospective purchaser in 1984, agreed to pur-

chase One New York Plaza at Simms' 1984 appraisal value of $382,430,000. Assume the individual was willing to put down $95,600,000 (25%) cash and was seeking a mortgage of $286,830,000. The bank would look to the actual and to the potential cash flow produced by One New York Plaza. It would find that the gross income (1984) was $39,317,000; that the basic fee operating expenses inclusive of taxes were $29,260,018; that net income was $10,056,982. The bank officer considering a $287,000,000 loan would have the building inspected. An inspection would reveal the grave need for additional capital improvements and the asbestos problem. Add to all of this, the fact that a 25 year 10% amortized mortgage of $286,830,000 would require annual mortgage payments of $32,822,000, a sum 3¼ times the present cash flow. The bank's conclusion, the selling price is too high; the risk is too great.

It is one thing for respondent defending the assessment to argue, the property should be taxed in 1984/85 as if it were worth $382,430,000; it is another for respondent's real estate witness to assert that the market value of the property is in fact $382,430,000 when it is so clear that it could not command such a price in the market.

If someone contemplated purchase of this property in 1984, the hard and soft cost of $124,538,427 to refurbish the building

would be considered. Each year under review the direct cost to repair will increase from about $124,338,427,in 1984, to approximately $134,310,312 in 1989. To the limited extent to which respondent's expert was compelled at the trial to address the problem, respondent would amortize these expenses over the life of the building and this only after they occur.

Over tax years 1984 through 1989, respondent's expert allowed $671,946 as an expense for asbestos survey, inspection, monitoring and abatement. This comes to an annualized expense of about .05 cents a square foot (p 31 respondent's appraisal). Other expenses, not connected with asbestos Simms would amortize over seven years. It is difficult to follow the anfractuous reasoning of this witness. He amortizes the Miller survey expense over 20 years; he amortized the asbestos abatement expenses on the 30th and 31st floor over 10 years and accepted as a valid expense charged to current income the limited asbestos abatement expense connected with the 19th and 20th floors. He also expensed against current income the semi- annual asbestos re-inspections and hygiene monitoring of respondent's witness Richard Miller.

The entire thrust of respondent's witness' testimony was to minimize expenses and maximize income. A property owner will write off expenses against income or amortize an actual expense

as an accountant may recommend or the tax law permits. Respondent's real estate appraiser is not being asked to make a judgment concerning the treatment of an actual expense. It is his task to place himself into the shoes of a prospective buyer who is concerned with the value of the actual and potential income stream of One New York Plaza. Whether the cost necessary to rehabilitate this property is expensed or amortized is a remote concern to a possible purchaser. Respondent's real estate witness created a web of expense distinctions that are a distraction. Whether the expense of asbestos abatement and physical rehabilitation is expensed or amortized is not the issue. The fact remains that respondent's legal and appraisal position that asbestos abatement and correction of the physical mechanical problems are not to be considered as effecting the value of this property is totally unsupportable. Since tax value has been equated with market value, it is reasonable to assume that a knowledgeable buyer would demand some abatement in the purchase price to compensate for the sums that will have to be expended to correct the building's physical and asbestos problems. Northville Industries Corp v Board of Assessors 143 A D 2d 135,138 (and cases cited therein) Re: Willowbrook 77 A D 2d 901,903. Simply, it is not possible to collect top market rents and have a low vacancy rate of 2½% without correcting the

problem in the building.

Further, respondent is in error in applying maximum market rental to each square foot of office space as a basis for estimating gross income, of an office building. (Tr.725). Except for a completely vacant office building, every multi-tenanted property has space leased for different periods of time. Thus at any one given time a landlord cannot obtain top market rent on every foot of space. A responsible appraiser would use a weighted average rent.

For the 1984/85 tax year respondent's appraiser Simms estimated rental value at $65,973,000 ($29.30 per square foot). In 1984 petitioner's actual gross receipts totaled $39,317,079 ($17.46 per square foot). Assuming the average offered rental in lower Manhattan for prime office space in 1984 was $31.00 to $34.00 per square foot, surely much of the space in such buildings would be occupied by tenants at lesser rents. The average rent then could not be $32.50 per square foot. Vacancy rates in 1984 were at least 8-10% further reducing an owner's ability to collect the then market rent. In a competitive rent market to gain a well rated long term tenant, landlords of necessity offer such tenants rent inducements. The Port of New York Authority (petitioner's office lease number 1, pg 81 petitioner's appraisal) as landlord of 7 World Trade Center gave petitioner's

tenant, Salomon Brothers a work letter totaling approximately $55,900,000. Salomon Brothers entry rent in October 1990 is $39.00 per square foot. Amortized over 20 years the tenants letter reduces landlord's square foot rental receipts to $36.50 per square foot. Returning to respondents' estimated rent of $29.30 per square foot, upon examination it is actually $31.80 per square foot. Simms reduces One New York Plaza's actual operating expense by $3.15 per square foot in 1984; $4.02 per square foot in 1985; $5.57 per square foot in 1986; $4.10 per square foot in 1987; $3.72 per square foot in 1988; $5.63 per square foot in 1989. Simms describes certain reimbursements by tenants for additional air conditioning, electrical cost, water and steam as services to tenants as non-expense items. (The chilled water service to Two New York Plaza $.65 per square foot in 1984 is properly excluded). Simms average rent per square foot in 1984 is thus effectively $31.70 per square foot which is only 13% less then what the Salomon lease entry rent was in a new building in 1990. During the first 15 months of the 7 World Trade Center lease, the Port Authority will not benefit by one penny from the listed rent of $39.00 per square foot. The contractors performing the tenant work letter will have been paid $55,900,000 by the Port Authority in advance of the Port Authority receiving any rent. And, during this 15 month period

the Port Authority will operate and maintain 1,118,000 square feet of Salomon Brothers space and while obligated to continue to make payments to the City of New York in lieu of real estate taxes. Seven World Trade Center and One New York Plaza are quite similar in size. The real estate taxes on One New York Plaza in 1989/90 fully transitionalized will amount to $16,216,300 or $7.20 per square foot. Simms' after tax operating expense for One New York Plaza in 1989/90 is an incredible low $4.31 per square foot (the actual operating expense was $10.81 per square foot). One must conclude from this that either energy, heat, labor, material, insurance and services costs in New York City are unusually low or, that real estate taxes are unusually high.

While postulating high estimated per square foot rent, Simms makes no allowance in his appraisal for tenant and improvement work letters expense and/or other rent allowances. His theory is that since the building is occupied under long term leases there is no need to allow for such expense or for rent allowances. He insists on increasing the actual rents and reducing the actual expenses. If the landlord is to get maximum market rents, the landlord has to pay a price to attain them. (See petitioner's appraisal pp. 81-95). Lease 1, Port Authority-Salomon lease $50.00 per square work letter; lease 3, $60.00 per

square foot work letter; lease 4, 13 months rent allowance; lease 7, $35.00 per square foot work letter, 4 months free rent; lease 9, $30.00 per square foot work letter; lease 10, 15 months free rent; lease 11, $43.25 per square foot work letter, 18 months free rent; lease 13, $40.00 per square foot work letter, 18 months free rent; lease 14, $35.00 per square foot workletter and landlord by purchasing an existing lease in effect gave up 11 months rent. The provisions in these leases represent what occurs in the actual market as opposed to Simms' hypothetical world.

Respondent's real estate witness estimates of income are grossly overstated. His expenses are very understated. His projections are unreliable. It would not be possible for a prospective purchaser to value anything on this witness' projections.

The original 1967 Chase lease which vexes respondent so, is not so different than the Port Authority-Salomon Brothers' lease (petitioner's lease number 1). The Chase lease for about one million one hundred thousand square feet of office space has provision for expense escalations as does the Port Authority lease for 1,118,000 square feet. Respondents complaint is that the Chase lease dose not provide for base rent escalation. The Port Authority's 20 year lease rent, considering only the

$55,900,000 work letter, effectively average $42.53 per square foot over its term based on the entry rent of $39.00 per square foot. The resulting effective average base rent escalation comes to only 5/100 of 1% one year hardly a significant base rent escalation.

The Chase - Salomon leases are for about 20acres of office space. We are not dealing with the ordinary office leases but with tenants that make the market. The Chase lease is not unique. The Port Authority Salomon lease results in a cumulative base rent of $908,039,000 net of- tenants alterations. Projecting only 5% annual escalation for expenses, the twenty year rent on this lease will exceed $2.7 billion. The Chase lease by 1984 has escalated roughly 200% over the base rent and at a higher rate of escalation.

When discussing lease rents, and here an assessing Authority's claim such rents are not market rent— People Ex-Rel Gale (supra) and Merrick v Board of Assessors 45 N Y 2d 538 must be addressed.

Gale and Merrick hold that for tax purposes, value arrived by capitalization must be based on fair rental value. Gale concerned a rooming house which was net leased at the same the rent for a long term without provision for any escalation. The rent was set during depressed economics time. The owner of the

property sought to base top value many years later on the rent received under the net lease.

In Merrick below market lease rents were made to three key retail tenants in a shopping mall. Pivotal in Merrick is that the key leases were not escalated. The Chase lease was made under normal market conditions at market rent and contained expense escalations. The Chase lease does not fall within the factual ambit of either Gale or Merrick.

Before dismissing the relevance of the Chase lease on market value it is well to consider the conditions under which it was made. Simms (Tr. 761 et seq.) characterized One New York Plaza as the "forerunner" in the downtown Water Street area. The developers created a building with large floor "foot-prints" particularly suitable to large institutional firms for which there was than a need. (Haims, Tr. 113a).

Respondent's appraiser concedes that it is usual in such buildings to attempt to attract a large first tenant as an inducement to others to rent. Particularly when a new area is being developed. This was the case with Chase who not only rented half the building on a long term lease but also supplied the construction loan. (Indeed, Chase "carried" the building on this "construction" loan well beyond the usual term associated with such loans).

However, respondent's appraiser not only ignored the Chase lease but all the other building contract rents applying instead his market rent to every square foot in the building. (Tr. 812) He quite candidly admitted that he treated the subject property for each year at issue as an empty building and applied his market rent to the space. (Tr. 775). He further stated that even if an actual lease was originally made at market rent he would disregard it, if not at market on the tax date. (Tr. 1049-1050).

If this method is valid assessing office buildings can be quite simple. Ignore contract rents, apply consensus market rents to all the space, apply "market" expenses and vacancy factors (or use the actual ones if that will increase value as Simms did) and capitalize the net hypothetical income at an appropriate rate. This method would eliminate the need to do audits or consider any of the individual characteristics of the property.

While Gale and its progeny require that fair market rents be the criterion in determining value for tax purpose, it does not authorize that the actual leases be ignored.

As stated in Gale p. 229 :

> "an outstanding lease may be a benefit or a detriment to the subject property and thus its duration, covenants and the rental fixed are simply elements along

> with other considerations used to arrive at the value of the property . . . .", and continuing p. 230, ". . . . of course an outstanding bona fide lease and the rental income established thereby are matters to be considered in determining the "full value" of the whole property. Value arrived at by capitalization of the fair rental value is in ordinary cases, the surest guide to a sound appraisal. In this connection the actual rent realized is significant as an important factor in determining what the fair value is (citations)."

The contract rents including the Chase at One New York Plaza were made at market rents and under normal if not somewhat elevated market conditions. (Tr. 1137). In fact, Simms concedes that ~~in a prior appraisal [1973]~~ he stated the Chase lease to be at market. (Tr. 1048)

Assuming, however, the applicability of Gale and Merrick to the Chase lease so as to require a "leasehold/bonus" be added to the rent to ~~arrive at a present fair rental.~~ Chase base entry rent is $5.88 per square foot. The other One New York Plaza office tenants averaged $10.23 per square foot. Adding a 85% bonus to the Chase entry rent so as to bring it to the same $10.23 and crediting thereon all subsequent escalations, the 1984/85 effective gross income for the building would be increased to $44,102,248 ($19.59 per square foot) from $39,317,079 ($17.46 per square foot). Applying respondent's vacancy rate of 2.5%; respondent's expense of $6.25 per square foot (actual expenses

$9.37 per square foot), the maximum theoretical net income for the purpose of taxation without any provision for correction of the problem in the building is $28,926,000. Applying Simms' overall capitalization rate of 14% to the before tax net income the maximum market value of this property for tax purposes is $206,614,000. The equalized assessed value would be $95,043,000. Of course, these assumptions make no provision for remedy of the building's asbestos and other physical problems and the effect of such costs on market value.

In appraising this property, petitioners' expert adopted discounted cash flow analysis (DCF). DCF is an assumption laden forecast of what may occur in the future. DFC as a technique delays direct capitalization until the income stream matures or stabilizes at its full potential. Petitioner's appraiser found it necessary to go out 20 years to 2003 to stabilize cash flow. The reason being that the asbestos problem in particular, unless the building were to be vacated, cannot be corrected before 1996 when leases terminate and space can be vacated. It is only when the prospect of an increase in cash flow becomes real that financing to correct the physical, mechanical and asbestos problems becomes possible. The lease profile of One New York Plaza will only fully reflect market rentals if the repairs are done and then not until the year 2002 and 2003. Under

petitioner's DCF analysis in 1994 and 1995 the cash flows are estimated to total $23,306,000, in 1998 and 1999 they are estimated by petitioner's expert to increase 291% to $91,103,000 and to finally stabilize at 448% above the 1994/95 rents at $127,620,000 in 2002 and 2003.

Much was being asked of both appraisers, one to defend the city's assessments; the other to find a plausible lesser value.

Chase Bank, the major tenant purchased this property in 1989. Respondent argues the purchase price of $141,000,000 is not market value and is thus irrelevant. It contends that the presence of an option to buy the building at three different intervals during the lease term at 120% of the cost of construction precludes consideration of the purchase price paid. The fact is Chase chose not to exercise the option when it was first available and the next date when it could be exercised was in 1995. Secondly, the option to buy was only for the building while the sale herein was of the complete fee. The reality of the circumstances at the time of this transaction was that the cash flow of this property would for a number of years continue to be inadequate to correct the problems indicated. Petitioner could undertake repairs and abatement of the asbestos only when it became feasible. This would occur when Chase occupant of almost 50% of the space might vacate the building. Chase Bank may very

well have decided to buy this property in advance of its option to purchase not because it could buy under market but because Chase could make a a large portion of the building available for repair as it saw fit and need not depend upon the cash flow to finance. Unlike petitioner, Chase can accelerate repairs, this is a considerable value adding advantage. It is questionable whether another investor without Chase's leverage to meet these problems would undertake this rehabilitation.

The market value of any income investment property is effected by the foreseeable risk. Buyers will shun investing where risk cannot be satisfactorily measured. Chase has control over the future of this property that petitioner could never have. However, respondent's appraiser persists in his head in the sand pretense that notwithstanding the problems of this property that there is little or no risk in the ownership and operation of the property, (respondents capitalization rate of 9.56% after inflation allows a real return of only 4.5%). Real estate taxes on the property have increased over the six year under review from $8,168,970 to $16,216,300 an increase of about 11% annually. In the opinion of this court neither the building or the land burdened by the building has increased in value over this time. The increases in value over the six years under review found in petitioner's appraisal are merely a function of

DCF. As the year 2003, when petitioner projects a value of $566,049,700 draws nearer the impact of the discount to present value increases. However, if 1983/84 was used as the base year, the picture is different. In 1983/84 the total assessment was $95,000,000. The State Board Equalization and Assessment ratio for 1983/84 is 49% which means the property was assessed on the basis of a market value of approximately $193,878,000. In 1989 petitioner's market value is $156,400,000. Thus based on 1983/84 tax year, petitioner's claimed market value in 1989 has decreased 24%. On the other hand, while the assessments increased 99% over this same period respondent's appraiser reports a value increase of 124%.

In arriving at fair taxation policy tax increases should not be sustained simply on the assumption they can be passed through to tenants as escalations and thus do not effect property owner's. Any increase in assessment whether paid by tenants as part of the lease rent or by a property owner effects property value. The taxes here have increased at double the rate of inflation. Property is to be taxed on the basis of market value not on the ability to pass the tax cost on to someone else. Further, the ability to pass along increases can only occur if there are tenants to pay them. Recent city-wide tenant defections to other jurisdictions may well reflect, in part, the result of this

pass-along philosophy.

The recent assessment history of One New York Plaza shows a marked escalation of assessments.

Year	Total Assessment
1981/82	$ 90,000,000
1982/83	85,000,000
1983/84	95,000,000
1984/85	145,000,000
1985/86	153,000,000
1986/87	153,000,000
1987/88	160,000,000
1988/89	170,000,000
1989/90	170,000,000

Considering what we now know about this property a $50,000,000 increase in assessment from 1983/84 to 1989/90 is not defensible.. Rents of primary and secondary office space weakened between December 1983 and 1984. Vacancy rates increased (pp 76 petitioners appraisal) and have continued to increase. The October 1987 market crash was ignored by the assessor. Indeed, the following 1988/89 assessment was increased $10,000,000 from $160,000,000 to $170,000,000.

The only evidence worthy of consideration in this record as to the value of One New York Plaza is petitioner's. However,

the court finds that the DCF method as employed by petitioner's appraiser is not particularly suited for valuation of this property for tax purposes.

DCF must be applied with caution particularly when the analysis involves cash flow projections over a long period of time. The degree of uncertainty in long term analysis of variable cash flows limits the reliability of DCF for appraisal purposes. A useful appraisal tool, DCF as applied by petitioner's appraiser may yet prove to be reasonably correct forecast of this property's value. However, buyers and sellers would be wise to look upon long term projections with caution. DCF analysis is much more convincing when used to estimate stabilized incomes within shorter time frames. In addition DCF may tend to exaggerate the impact on present values of future income and expense projections as the time for said projected events draws closer. Further, assessments and supporting values may be reviewed annually, thus obviating to some extent the need to speculate as to future assumptions.

The basis of the court's findings as to the value of this property can be understood by examining respondent's 1984/85 market value of $382,430,000. On an overall square foot basis. The rent would be computed at $29.75 a square foot.

If the tenants are paying $29.75 in rent and $3.80 for what

the witness terms services, they would be really paying landlord-petitioner $33.55 per square foot. By whatever name, respondent's hypothetically imposed gross income must then be $74,305,473. This estimate is 89% more than the actual gross income of $39,317,749 of One New York Plaza.

Respondent postulates a weighted average rent of at least $29.75 per square foot. Assume a weighted average rent of 50% over the actual rent of $17.46, i.e. $26.19 per square foot; a "market" vacancy rate of 8% consistent with such a rent, expenses of $25,000,000 ($11.10 per square foot, taxes $3.63 per square foot operating expense $7.47 per square foot), assumptions which greatly favor respondent. The net income would be $29,256,400 ($12.99 per square foot). Keep in mind a $12.99 per square foot net presupposes a hypothetical $26.19 per square foot rent. A prospective purchaser would be confronted with the problem of rehabilitating the property so that it may achieve the market rent promised in this example. That cost in 1984 is about $121,000,000. If a purchaser undertook to correct the problem within say seven years his 1984/85 cost would be $17,286,000 a year. This expense would somehow have to be charged against income whether expensed or amortized. These are the most favorable assumptions the Tax Assessor and Tax Commission could possibly have made. However, they completely dis-

regarded the problems with this building. They raised the 1984/85 assessment $50,000,000 from $95,000,000 to $145,000,000. In doing so they raised their estimate of the market value of this property from $193,877,551 to $290,000,000. This 1984/85 market value of $290,000,000 is the equivalent of capitalizing a net income before taxes of $40,600,000 at Simms' extremely conservative overall rate of 14% whereas the actual net income of this property before taxes was $18,226,707. To reach this $290,000,000 value the $10,057,737 actual income after taxes must be capitalized at about 3.5%, an amount that is less than the 5% average rate of inflation over the last 50 years.

A tax that reduces the percentage yield to less than the rate of inflation confiscates capital. Such taxation is not in the public interest. It will prove to be shortsighted and irresponsible in that it depresses the tax base. An investor, will not put up capital if the return on capital is taxed away.

The reality is that the value of this property will increase tremendously just as soon as its problems are corrected. That potential is understated in petitioner's analysis.

To reach an assessment fair to both petitioner and to respondent, the court turns to the 1983/84 assessment. For in 1983/84 there was a consensus as to the market value and tax value of this property.

In 1983/84 that value was $193,878,000 ($95,000,000 assessment, ratio 49%). If we assume for 1984/85 a high basic net income of $12.99 per square foot, a $193,878,000 market value would indicate an overall capitalization rate of 15%. It is perhaps possible someone would undertake the ownership of this property in its condition for a return of 15%. The return would of course prove to be much less when additional capital investment of ultimately perhaps $150,000,000 would be put into the property. In the court's opinion the 1983/84 market value of $193,878,000 is the maximum value one can place on the property. With good fortune, if financing proved available, such an investment might prove successful. It is evident the purchase of the property One New York Plaza would involve considerable risk. Since 1983/84 as far as this property is concerned nothing has changed for the better.

The prime interest rate has averaged 9.64%, (It can be observed that Simms' basic capitalization rate of 9.56% is less than the average prime rate) the risk of pollution, public awareness of asbestos the risk of litigation and vacancy rates has increased. The physical / mechanical condition of the property continues to decline. After October 1987 there was a general decline in the real estate market. Weighing all the factors, it is the court's finding that the value of this

property has not increased over the period under review.

The corrected actual assessments after applying the appropriate ratio for each year are as follows:

1984/85	$89,184,000
1985/86	96,939,000
1986/87	104,694,00
1987/88	116,327,000
1988/89	98,184,000
1989/90	85,306,000

Solely for the purposes of § 502 (3) RPTL the court will adopt the 1983/84 assessor's proportion of land to total assessment, i.e. 27%, to all years. (See New York City Administrative Code § 11-207 [b]).

Settle order

Dated: 1/18/91

J. S. C.