

TAX COURT OF NEW JERSEY

Kathi F. Fiamingo
Judge



153 Halsey Street, 8th Floor
P.O. Box 47025
Newark, New Jersey 07101
Tel: (973) 648-2921 Fax: (973) 648-2149

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THE TAX COURT COMMITTEE ON OPINIONS

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Robert D. Blau, Esq.
Blau & Blau
223 Mountain Avenue
Springfield, NJ 07081

Gary J. Cucchiara, Esq.
Law Offices of Gary J. Cucchiara, LLC
30 Park Avenue
Lyndhurst, NJ 07071

RE: Glow Properties v. Borough of North Arlington
Docket No. 018168-2011, 018531-2012, 017073-2013 & 015368-2014

Counsel:

This letter constitutes the court's opinion after trial in the above-referenced matter challenging the 2011 through 2014 tax year assessments on plaintiff's property. For the reasons stated more fully below, the assessments are reduced.

I. Procedural History and Factual Findings

The court makes the following findings of fact based on the evidence and testimony offered at trial in this matter.

The subject property consists of two adjacent lots located at 75-81 Porete Avenue in the Borough of North Arlington, New Jersey, located in Bergen County. On the Borough's tax map, the subject property is designated as Block 168, Lots 9.01 and 10.01 (the "subject property").

For tax years 2011 - 2014, the subject property was assessed as follows:

Block 168 Lot 9.01	Land:	\$ 336,700
	Improvements:	<u>\$ 338,400</u>
	Total:	\$ 675,100
Block 168 Lot 10.01	Land:	\$ 111,400
	Improvements:	<u>\$ 42,400</u>
	Total:	\$ 153,800
Combined	Land:	\$ 448,100
	Improvements:	<u>\$ 380,800</u>
	Total:	\$ 828,900

The average ratio of assessed to true value, commonly referred to as the Chapter 123 ratio, for the Borough of North Arlington (“defendant”) for the 2011 tax year was 100% making the implied equalized value of the subject property \$828,900 for that year¹. For the 2012 tax year the Chapter 123 ratio was 95.09%, making the implied equalized value \$871,700. For 2013 and 2014 the Chapter 123 ratio exceeded 100%.

Plaintiff filed timely appeals with the Bergen County Board of Taxation challenging the assessment on the subject property for each of the tax years 2011-2014. The Board affirmed the assessments for each of the years. Thereafter, plaintiff filed timely Complaints in this court contesting the Board’s Judgments.

The subject property consists of .90 total acres and is improved by two buildings. The first building contains approximately 4,560 square feet. It is a one and partial two story concrete block and brick industrial truck terminal style building (“main building”). It contains sixteen loading dock doors (eight doors on opposing sides of the building), a warehouse area with ceiling heights of 23 feet and office space. The second building consists of a concrete block industrial garage building (“garage building”) containing approximately 800 square feet.²

¹ The Borough of North Arlington conducted a revaluation for the 2011 tax year.

² The parties disputed the size of the improvements on the property with the plaintiff’s expert contending that the main building contained 4,511 square feet, while the defendant’s expert maintained it contained 4,560 square feet.

The front portion of the lot is generally level at road grade. The rear of the property is steeply sloped upward, forming a cliff, prohibiting any improvement. The subject property is located in the Borough's Porete Avenue Redevelopment Area permitting light industry uses, warehouse and distribution facilities, general business and professional offices, and public uses. At 0.9 acres, the subject property does not meet the minimum lot size requirement of 1 acre but is considered a legal, pre-existing non-conforming use.

When built, the improvements were intended to be utilized as a truck terminal, where trucks would pull up to the loading dock doors and unload their goods, which would then be loaded on to other trucks for further distribution. That use fared well when smaller sized trucks were standard in the industry. Currently the standard sized truck is 53 feet in length. The site cannot accommodate the larger vehicles because there is insufficient room on site for them to turn around and back up to the loading dock doors and the access to the subject site via Porette Avenue is "tight", requiring the larger trucks to back up into other properties. Furthermore, the size of the larger trucks prohibits the use of more than one or two loading doors at a time when they are parked at the dock doors.

From August 2008 until July 2013 the building was leased to a food distribution company which utilized smaller 25 foot trucks and vans for local distribution. Thus, through July 2013, the subject property was utilized for its original intended purpose as a warehouse/truck terminal. At the end of that lease the plaintiff was unable to obtain a replacement industrial warehouse tenant despite active marketing of the subject property for such a tenant. The plaintiff did secure a tenant which operates a dog boarding kennel, and which entered into a lease for that purpose in October

Similarly, plaintiff's expert maintained that the garage contained 756 square feet while the defendant's expert contended that the garage contained some 800 square feet. Neither expert provided a basis for the determination of the square footage or the reason for the difference.

2013. The subject site backs up to a wooded area and is located some distance from residential properties making the subject site particularly well suited to the use as a dog kennel.

Each party offered the testimony of a State of New Jersey certified general real estate appraiser who was accepted without objection as an expert in the field of real estate valuation (the “plaintiff’s expert” and the “defendant’s expert” respectively). Both experts prepared an appraisal report, each of which was admitted into evidence without objection.

The experts’ conclusions as to value are as follows:

<u>Valuation Date</u>	<u>Plaintiff’s Conclusion</u>	<u>Defendant’s Conclusion</u>
October 1, 2010	\$515,000	\$700,000
October 1, 2011	\$540,000	\$730,000
October 1, 2012	\$540,000	\$740,000
October 1, 2013	\$565,000	\$750,000

Plaintiff also presented testimony from one of its principal owners and its leasing broker.

II. Conclusions of Law

A. Presumption of Validity

The court’s analysis begins with the well-established principle that “[o]riginal assessments and judgments of county boards of taxation are entitled to a presumption of validity.” MSGW Real Estate Fund, LLC v. Borough of Mountain Lakes, 18 N.J. Tax 364, 373 (Tax 1998). As Judge Kuskin explained, our Supreme Court has defined the parameters of the presumption as follows:

The presumption attaches to the quantum of the tax assessment. Based on this presumption the appealing taxpayer has the burden of proving that the assessment is erroneous. The presumption in favor of the taxing authority can be rebutted only by cogent evidence, a proposition that has long been settled. The strength of the presumption is exemplified by the nature of the evidence that is required to overcome it. That evidence must be “definite, positive and certain in quality and quantity to overcome the presumption.”

[Ibid. (quoting Pantasote Co. v. City of Passaic, 100 N.J. 408, 413 (1985)(citations omitted)).]

The presumption of correctness arises from the view “that in tax matters it is to be presumed that governmental authority has been exercised correctly and in accordance with law.” Pantasote, *supra*, 100 N.J. at 413 (citing Powder Mill, I Assocs. v. Township of Hamilton, 3 N.J. Tax 439 (Tax 1981)); see also Byram Twp. v. Western World, Inc., 111 N.J. 222 (1988). The presumption remains “in place even if the municipality utilized a flawed valuation methodology, so long as the quantum of the assessment is not so far removed from the true value of the property or the method of assessment itself is so patently defective as to justify removal of the presumption of validity.” Transcontinental Gas Pipe Line Corp. v. Township of Bernards, 111 N.J. 507, 517 (1988)(citation omitted).

“In the absence of a R. 4:37-2(b) motion . . . the presumption of validity remains in the case through the close of all proofs.” MSGW Real Estate Fund, LLC, *supra*, 18 N.J. Tax at 377. In making the determination of whether the presumption has been overcome, the court should weigh and analyze the evidence “as if a motion for judgment at the close of all the evidence had been made pursuant to R. 4:40-1 (whether or not the defendant or plaintiff actually so moves), employing the evidentiary standard applicable to such a motion.” Ibid. The court must accept as true the proofs of the party challenging the assessment and accord that party all legitimate favorable inferences from that evidence. Id. at 376 (citing Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 535 (1995)). In order to overcome the presumption, the evidence “must be ‘sufficient to determine the value of the property under appeal, thereby establishing the existence of a debatable question as to the correctness of the assessment.’” West Colonial Enters, LLC v. City of East Orange, 20 N.J. Tax 576, 579 (Tax 2003) (quoting Lenal Props., Inc. v. City of Jersey City, 18 N.J. Tax 405, 408 (Tax 1999), aff’d, 18 N.J. Tax 658 (App. Div.), certif. denied, 165 N.J. 488 (2000)).

The defendant made a motion to dismiss for failure to overcome the presumption of correctness at the end of the plaintiff's case. The court reserved on the motion. The court finds that plaintiff produced sufficient credible evidence to overcome the presumption of validity. If taken as true, the opinion of plaintiff's expert creates a debatable question regarding the correctness of the assessments in each tax year sufficient to allow the court to make an independent determination of the value of the subject property. Plaintiff's expert opined that on the relevant valuation dates the subject property was worth between \$288,900 to \$314,000 less than the implied equalized value. Thus, if taken as true, the opinion of plaintiff's expert supports a conclusion that the subject property was assessed well in excess of its true market value for both tax years. The court therefore denies defendant's motion to dismiss for failure to overcome the presumption of correctness.

The court's inquiry, however, does not end here. Concluding the presumption of validity has been overcome does not equate to a finding by the court that the assessment is erroneous. Once the presumption has been overcome, "the court must then turn to a consideration of the evidence adduced on behalf of both parties and conclude the matter based on a fair preponderance of the evidence." Ford Motor Co. v. Township of Edison, 127 N.J. 290, 312 (1992). The court must be mindful that "although there may have been enough evidence [presented] to overcome the presumption of correctness at the close of plaintiff's case-in-chief, the burden of proof remain[s] on the taxpayer throughout the entire case...to demonstrate that the judgment under review was incorrect." Id. at 314-15 (citing Pantasote Co., supra, 100 N.J. at 413). Only after the presumption is overcome with sufficient evidence at the close of trial must the court "appraise the testimony, make a determination of true value and fix the assessment." Rodwood Gardens, Inc. v. City of Summit, 188 N.J. Super. 34, 38-39 (App. Div. 1982)(citations omitted).

Accordingly, the court will evaluate and weigh the evidence presented to determine if plaintiff has met the requisite burden of proof.

B. Highest and Best Use

In determining the market value of a property, the court must first find the highest and best use of that property. As explained in Clemente v. Township of South Hackensack, 27 N.J. Tax 255, 267-269 (Tax 2013), aff'd o.b. 28 N.J. Tax 337 (App. Div. 2015):

For property tax assessment purposes, property must be valued at its highest and best use. Ford Motor Co. v. Township of Edison, 127 N.J. 290, 300-01, 604 A.2d 580 (1992). “Any parcel of land should be examined for all possible uses and that use which will yield the highest return should be selected.” Inmar Associates, Inc. v. Township of Edison, 2 N.J. Tax 59, 64 (Tax 1980). Accordingly, the first step in the valuation process is the determination of the highest and best use for the subject property. American Cyanamid Co. v. Township of Wayne, 17 N.J. Tax 542, 550 (Tax 1998), aff'd 19 N.J. Tax 46 (App. Div. 2000). “The concept of highest and best use is not only fundamental to valuation but is a crucial determination of market value. This is why it is the first and most important step in the valuation process.” Ford Motor Co. v. Township of Edison, 10 N.J. Tax 153, 161 (Tax 1988) aff'd o.b. per curiam, 12 N.J. 290, 604 A.2d 580 (1992); see also Gen. Motors Corp. v. City of Linden, 22 N.J. Tax 95, 107 (Tax 2005).

The definition of highest and best use contained in The Appraisal of Real Estate, a text frequently used by this court as a source of basic appraisal principles, has remained relatively constant for all of the years under appeal. Highest and best use is defined as:

The reasonably probable and legal use of vacant land or improved property that is physically possible, appropriately supported, and financially feasible and that results in the highest value.

[Appraisal Institute, The Appraisal of Real Estate, 22 (13th ed. 2008)]

The highest and best use analysis requires sequential consideration of the following four criteria, determining whether the use of the subject property is: 1) legally permissible; 2) physically possible; 3) financially feasible; and 4) maximally productive. Ford Motor Co., supra, 10 N.J. Tax at 161; See also, The Appraisal of Real Estate at 279. Implicit in this analysis is the assumption that the proposed use is market-driven; in other words, that it is determined in a value-in-exchange context and that there is a market for such use. WCI-Westinghouse v. township of Edison, 7 N.J. Tax 610, 616-617 (Tax 1985), aff'd o.b. per curiam, 9 N.J. Tax 86 (App. Div. 1986). A highest and best use determination is not based on value-in-use because the determination is a function of property use and not a function of a

particular owner's use or subjective judgment as to how a property should be used. See Entenmann's Inc. v. Borough of Totowa, 18 N.J. Tax 540, 545 (Tax 2000). The highest and best use of an improved property is the "use that maximizes an investment property's value, consistent with the rate of return and associated risk." Ford Motor Co., *supra*, 127 N.J. at 301, 604 A.2d 580. Further, the "actual use is a strong consideration in the analysis. Ford Motor Co., *supra* 10 N.J. Tax at 167.

Highest and best use is not determined through subjective analysis by the property owner. The Appraisal of Real Estate at 279. The proper highest and best use requires a comprehensive market analysis to ascertain the supply and demand characteristics of alternative uses. See, Cherry Hill, Inc. v. Township of Chery Hill, 7 N.J. Tax 120, 131 (Tax 1984), *aff'd*, 8 N.J. Tax 334 (App. Div. 1986). Additionally, the proposed use must not be remote, speculative or conjectural. *Id.* If a party seeks to demonstrate that a property's highest and best use is other than its current use, it is incumbent upon that party to establish that proposition by a fair preponderance of the evidence. Penn's Grove Gardens, Ltd. v. Borough of Penns Grove, 18 N.J. Tax 253, 263 (Tax 1999); Ford Motor Corp., *supra* 10 N.J. Tax at 167. Property should be assessed in the condition in which it is utilized and the burden is on the person claiming otherwise to establish differently. Highview Estates v. Borough of Englewood Cliffs, 6 N.J. Tax 194, 200 (Tax 1983).

The highest and best use opinion offered by both the experts was the current use of the subject property. Although plaintiff produced credible testimony that, due to functional obsolescence, the continued use of the subject property for a warehouse in the current market was not feasible, plaintiff's expert's conclusion on highest and best use appears to be that of an industrial use. Furthermore, to the extent plaintiff's expert reviewed any comparables, they were of industrial warehouse properties and in concluding a capitalization rate, the market studies and other material referred to by plaintiff's expert referenced solely industrial warehouse properties.

Plaintiff's expert also references the limitations on industrial uses that are serviced by trucks with large trailers and references the "existing dog housing use", which it appears he concludes is an industrial use. While the court is skeptical that a dog kennel constitutes an industrial or warehousing use, the court accepts the experts' conclusions that the highest and best use for the subject property as of the dates of valuation was as a warehouse/truck terminal.

C. Valuation Methodology

“There are three traditional appraisal methods utilized to predict what a willing buyer would pay a willing seller on a given date, applicable to different types of properties: the comparable sales method, capitalization of income and cost.” Brown v. Borough of Glen Rock, 19 N.J. Tax 366, 376 (App. Div. 2001)(citing Appraisal Institute, The Appraisal of Real Estate 81 (11th ed. 1996), certif. denied, 168 N.J. 291 (2001)). “[T]he answer as to which approach should predominate depends upon the facts in the particular case.” WCI-Westinghouse, Inc. v. Township of Edison, 7 N.J. Tax, 610, 619 (Tax 1985), aff’d, 9 N.J. Tax 86 (App. Div. 1986).

The income capitalization approach is the preferred method of estimating the value of income producing property. Parkway Village Apartments Co. v. Township of Cranford, 108 N.J. 266, 270 (1987); Hull Junction Holding Corp. v. Borough of Princeton, 16 N.J. Tax 68, 79 (1996). “The income capitalization approach to value consists of . . . procedures that an appraiser uses to analyze a property’s capacity to generate benefits (i.e., usually the monetary benefits of income and reversion) and convert these benefits into an indication of present value.” Appraisal Institute, The Appraisal of Real Estate 439 (14th ed 2013).

Plaintiff’s expert utilized the income capitalization approach as the sole method of valuing the subject property because, as he noted, “it’s been a leased property for several years” and as far as he knew “it would continue to be a leased property.” He further noted that there were two leases for the subject property in effect during the years in question, one as of October 2013, the last valuation date and one as of 2008, just prior to the first valuation date of October 2010. He found that the income approach was the most appropriate method of valuing the subject property due to the quantity of the data and the “unusual” nature of the property, i.e. an industrial building now in use as a dog kennel because its intended use as a truck terminal was no longer feasible.

Defendant's expert utilized both the sales comparison method and the income capitalization method to value the subject property. The sales comparison approach derives an opinion of market value "by comparing properties similar to the subject property that have recently sold, are listed for sale, or are under contract." Appraisal Institute, The Appraisal of Real Estate 377 (14th ed. 2013). The sales comparison approach involves a "comparative analysis of properties" and requires the expert to focus on the "similarities and differences that affect value...which may include variations in property rights, financing, terms, market conditions and physical characteristics." Id. at 378. "When data is available, this [approach] is the most straight forward and simple way to explain and support an opinion of market value." Greenblatt v. Englewood City, 26 N.J. Tax 41 (Tax 2011)(citing Appraisal Institute, The Appraisal of Real Estate 300 (13th ed. 2008)).

Defendant's expert opined that the sales comparison approach was an appropriate methodology because although the subject property is leased, smaller industrial buildings are often purchased "many times" for owner occupancy and not for income producing ability. He indicated that he used both approaches (sales comparison and income) as a secondary check for his overall conclusion of value. Thus, he reviewed eleven sales of industrial warehouse property as being comparable to the subject property.

The court finds that the income capitalization approach is the most appropriate approach to value the subject property. See, Hull Junction, supra, 16 N.J. Tax 79 ("the income approach is . . . the proper method for determining the value of [property which produces income].")

D. Calculation of Value using the Income Approach

Determining the value of real property pursuant to the income approach is achieved by the following process:

<u>Times</u>	x	<u>Market Rent</u>	x	<u>Square footage</u>
Equals		=		Potential Gross Income
<hr style="width: 100%;"/>				
<u>Less</u>		-		<u>Vacancy Rate and Collection Losses</u>
Equals		=		Effective Gross Income
<hr style="width: 100%;"/>				
<u>Less</u>		-		<u>Operating Expenses</u>
Equals		=		Net Operating Income
<hr style="width: 100%;"/>				
<u>Divided by</u>		÷		<u>Capitalization Rate</u>
Equals		=		Property Value

See, Spiegel v. Town of Harrison, 19 N.J. Tax 291, 295 (App. Div. 2001), aff'g, 18 N.J. Tax 416 (Tax 1999).

E. Determination of Market Rents

“Central to an income analysis is the determination of the economic rent, also known as the ‘market rent’ or ‘fair rental value.’” Parkway Village Apartments, supra, 108 N.J. at 270. This differs from the actual rental income from the subject property, which may be below market rates. Parkview Village Assocs. v. Borough of Collingswood, 62 N.J. 21, 29-30 (1972). Despite that, “actual income is a significant probative factor in the inquiry as to economic income.” Id. at 30.

Plaintiff’s expert relied primarily on the subject leases in determining the market rents. However, he also reviewed asking rental rates for smaller industrial spaces within a three mile radius of the subject property and ten comparable leases in reaching his conclusion as to market rent. In reviewing asking rental rates, plaintiff’s expert reviewed the CoStar survey of asking rates from 2004 through 2014 for 177 industrial buildings containing between 2,000 and 10,000 square feet within a three mile radius of the subject. He determined that the asking rental rates ranged from \$6.00 to \$11.00 per square foot net over the ten year review period. Asking rates are generally unreliable indicators of a subject's value. They “represent only one half of the necessary equation” namely, a willing landlord, but no willing tenant. Korvettes Home Furnishing Ctr. v. Borough of Elmwood Park, 1 N.J. Tax 287, 291 (Tax 1980). Furthermore lease terms “could well change”

when the lease is finally consummated. Lamm Assocs. v. Borough of Caldwell, 1 N.J. Tax 373, 379 (Tax 1980). Thus, the offers are not “evidentiary and may not be considered in determining a property's economic rent.” Harrison Realty Corp. v. Township of Harrison, 16 N.J. Tax 375, 381-83 n.3 (Tax 1997) (citations omitted), aff'd, 17 N.J. Tax 174 (App. Div. 1997), certif. denied, 153 N.J. 213, 708 A.2d 64 (1998).

In the identification of the comparable leases, plaintiff's expert failed to identify the landlord for each of the leases set forth in his appraisal as required by R. 8:6-1(b)(2). Defendant moved to strike the entire report and plaintiff's expert testimony as a result. The cited rule is a discovery rule requiring a litigant intending to rely on rentals of comparable properties to furnish a list of the rentals setting forth the “location of the property by block, lot, street, street number and municipality . . . and name of landlord and tenant, date of lease and relevant lease terms.” R. 8:6-1(b)(2). That information is to be provided prior to trial. R. 8:6-1(b)(1). While it is clear that plaintiff's expert report did not set forth the required information as to the identity of the landlord (or the tax Block and Lot of the comparable leased properties), the municipality did not indicate how it was prejudiced by failing to have the omitted information, nor did defendant cite any rule or standard stating that an appraisal report which fails to contain such information is defective. The court declines to strike plaintiff's entire report for a discovery violation which defendant could have called to the attention of plaintiff prior to trial for correction.

For tax year 2011, excluding the subject leases described infra, plaintiff's expert reviewed two leases with lease terms beginning in November 2009 through December 2010. The rents, prior to adjustment, ranged from \$10.72 to \$12.00 per square foot. After adjustment, the rents ranged from \$11.26 to \$12.00 per square foot net.³

³ For every comparable lease utilized by plaintiff's expert, the adjusted rents for all years were incorrectly calculated. For example, for Comparable Lease 2, although the aggregate adjustments totaled 0, plaintiff's expert inexplicably adjusted the actual rent of \$12.00 per square foot to \$13.00 per square foot. Plaintiff did not explain how

For tax year 2012, plaintiff's expert reviewed five comparable leases with lease terms commencing June 2011 through December 2011. The rents, prior to adjustment, ranged from \$10.21 to \$12.50 per square foot. After adjustment, the rents ranged from \$10.53 to \$12.50 per square foot net.

For tax year 2013, plaintiff's expert reviewed one comparable lease with a lease term beginning July 2012 and ending April 2017. This lease had an unadjusted rent of \$11.18 per square foot and an adjusted rent of \$11.18 per square foot net.

For tax year 2014, plaintiff's expert reviewed two comparable leases for terms commencing November 2013 and terminating November 2018. The unadjusted rents ranged from \$10.11 to \$10.20 per square foot net. After adjustment, the rents ranged from \$10.20 to \$10.61.

Plaintiff's expert also reviewed the subject leases upon which he relied in concluding market rents. The first subject lease commenced on August 1, 2008 and terminated on July 31, 2013. The subject property was leased on a modified gross lease in which the landlord pays the base year's taxes for the duration of the lease. Any increase in the property taxes over the base year, which was specified as calendar year 2008, was to be paid by the tenant. The actual amount of the 2008 taxes to be paid by landlord was not specified in the lease, nor did plaintiff's expert provide that amount. The rent schedule is outlined below:

Months	Monthly Rent	Yearly Rent
8/1/2008 – 1/31/2009	\$5,000	\$60,000
2/1/2009 – 1/31/2010	\$6,000	\$72,000
2/1/2010 – 1/31/2011	\$6,500	\$78,000
2/1/2011 – 1/31/2012	\$6,500	\$78,000
2/1/2012 – 7/31/2013	\$7,000	\$84,000

the error occurred nor did the defendant question him on his conclusions during cross examination. The adjusted rents set forth in the body of this opinion have been determined by correctly applying the adjustments made by plaintiff's experts to the reported unadjusted rents.

The second subject lease commenced on November 1, 2013 and is to terminate on December 31, 2023.⁴ As with the first subject lease, the rent is on a modified gross lease where the landlord pays the base year's taxes (2013 in this case) for the duration of the lease. Any increase in the property taxes over the calendar year 2013 are paid by the tenant. In the second subject lease, the 2013 taxes which are to be paid by landlord were specified to be \$23,258.94.

The monthly rents in this lease are as follows:

Months	Monthly Rent	Yearly Rent
Months 1-24	\$6,500	\$78,000
Months 25-48	\$6,750	\$81,000
Months 49-72	\$7,100	\$85,200
Months 73-96	\$7,400	\$88,800
Months 97-120	\$7,700	\$92,400

Plaintiff's expert described the "leased area" for both subject leases as 4,511 square feet, thus excluding the garage building from the calculation altogether. However a review of both subject leases results in a contrary conclusion. Paragraph 26 of the first subject lease requires that "the terminal and garage will be broom clean" and "the garage will be empty of all items prior to lease commencement."

The second subject lease specifically describes the "Building Area" as Lots 9.01 and 10.01 in Block 168, thus including both improvements. Yet to the extent plaintiff's expert referenced rents on a square foot basis, he included only the square footage of the warehouse and at no time explained his reasoning in excluding the garage. Thus the rents, described on a square foot basis, were distorted.

⁴ The plaintiff's expert cited the commencement date as February 1, 2014 and the termination date as January 31, 2024. The actual lease document submitted into evidence has the commencement date as November 1, 2013 and the termination date as December 31, 2023. Rent for the first sixty days was abated possibly accounting for the difference in the start date of the lease.

Plaintiff's expert noted that the subject rents, on a per square foot basis, were higher than those on the comparable leases since local industrial space tends to rent on a net basis, with tenants paying all property taxes. Nonetheless he determined that the average rentals for the two subject leases (\$76,800 for the first subject lease and \$85,080 for the second subject lease) were representative of the market. He concluded that estimated market rental rates for the subject, on a gross basis (landlord paying property taxes, leasing commissions, management expenses and reserves and repairs), were \$78,000 per year for each of the years under review.

In support of this conclusion, the plaintiff's expert testified that the concluded gross rents of \$78,000 per year amounted to approximately \$17.29 per square foot if converted to a square foot basis⁵; that the comparable rents supported a conclusion of \$12.00 per square foot on a net basis⁶; and that the \$5.00 per square foot adjustment for taxes during the years in question was appropriate because that was the amount the landlord had paid in taxes during the last four years. It appears that plaintiff's experts conclusions might be affected by the mathematical error made by him in adjusting the comparable rents. The effect of this error on his final conclusions cannot be known. Furthermore, although the expert testified that the market rents were concluded on a modified gross basis, with the landlord paying the referenced base taxes, his report indicates the market rents are calculated on a gross basis with landlord paying all taxes.

Defendant's expert, in estimating market rents, reviewed nine leases of comparable property, all of which were net rents with unadjusted rents ranging from \$8.95 to \$16.32, and

⁵ Again this calculation includes only the warehouse building and allocates no rental value to the garage building.

⁶ The court notes that the second subject lease rentals are predicated on the landlord paying \$23,258.94 in base taxes. Taking into account the square footage of the warehouse only, the tax component is \$5.16 per square foot and the net rents would adjust to \$12.13 per square foot for the first 24 months, \$12.80 for months 25-48, \$13.73 for months 49-72, \$14.53 for months 73-96 and \$15.33 for months 97-120. Including the additional square footage of the garage produces a tax component of \$4.42 per square foot and net rents of \$10.39, \$10.96, \$11.76, \$12.44 and \$13.12, respectively. Without any information as to the taxes for 2008 the court is unable to determine the net rents for the first subject lease, which was in effect during the majority of the years under review.

adjusted rents ranging from \$9.85 to \$13.87. He concluded a market rental of \$11.50 per square foot for each of the years under review. His conclusion of annual rent resulted in \$61,640, utilizing 5,360 square feet as the rentable area.

Plaintiff's use of a gross rental, inclusive of the taxes when comparable properties rent on a net basis, presents an inappropriate manner of determining market rents in this matter. See, Spiegel v. Town of Harrison, 18 N.J. Tax 416, 423 (Tax 1999); aff'd 19 N.J. Tax 291 (App. Div. 2001) (Court used net rentals to value warehouse where subject lease provision requiring landlord to pay taxes in excess of a certain dollar figure was unusual and not typical of the marketplace and comparable rents on a net basis were used by both experts.) Plaintiff's expert provided no evidence of comparable rentals on a gross or modified gross basis to support any of his conclusions.

The court also rejects plaintiff's expert's reliance on the subject leases. While plaintiff's expert maintained that he relied on the subject leases because the property was "unique", being an industrial property utilized as a dog kennel, in fact during the years under review the highest and best use of the property is as an industrial warehouse for which substantial comparable lease data is available.

Additionally, plaintiff's expert's attempt to support the rents under the subject leases is suspect both for the failure to include all of the leased premises within the square footage calculation in the subject leases and the inexplicable errors in making the rent adjustments to the comparable leases.

The court accepts the conclusions of defendant's expert as to the market rents and finds that \$11.50 per square foot is market rent for the subject property on a net basis. Thus, the court finds that potential gross income of the subject property is to be determined by multiplying the square footage of both the warehouse and the garage by the market rent – $5,360 \times \$11.50 = \$61,640$.

F. Vacancy and Collection Rate

Plaintiff's expert estimated a vacancy rate of 5% and a collection loss rate of 3%. The estimate of vacancy rates was based on surveys of industrial and warehouse buildings, including buildings within a three mile radius of the subject. His estimate of collection loss was based on his observation that "[c]ollection losses within older small industrial buildings such as the subject would be expected to be greater than those within newer and larger buildings since these older buildings would be more likely to attract tenants with greater credit risk." He thus concluded an overall rate of 8% for vacancy and collection losses.

Defendant's expert concluded that a vacancy and non-collection loss of 5% of potential gross income was appropriate based on a review of the vacancy rates at the subject property, survey of the local market, conversations with market participants and market studies. None of the objective data was provided to the court and the court is unable to assess the reliability of the data.

The evidence presented supports a vacancy rate of 5%. The court also concludes that a 3% non-collection loss is reasonable.

G. Operating Expenses

The subject property is being valued on a net basis, with tenant paying all expenses, other than leasing commission, management fees, and reserves and repairs. Plaintiff's expert opined that the appropriate stabilized leasing commission was 5%. He based this primarily on the subject lease, which provides for a 5% commission rate and his conversation with the subject's broker. Plaintiff's expert further opined that a management fee of 4% was appropriate, but provided no objective data to support this opinion.

Defendant's expert opined an overall expense rate of 5%, 2.5% for management fees and 2.5% for stabilized leasing expense. He referenced a survey of national warehouse markets for the third quarter of each year under review in support of his expense rate, tending to support 2.5%.

Based on the evidence before the court, the court concludes that a leasing commission rate of 5% and a management fee of 2.5% is appropriate.

H. Reserves for repairs

Both experts agreed on a 2% allowance for reserves for repairs and replacements.

I. Capitalization Rate

“Any interest in real estate that is capable of generating income can be valued using direct capitalization. The direct capitalization formula is:

$$\text{Value} = \text{Net Operating Income} \div \text{Overall Capitalization Rate.}”$$

[Appraisal Institute, The Appraisal of Real Estate 492 (14th ed 2013).]

The overall capitalization rate is an “income rate for a total real property interest that reflects the relationship between a single year’s net operating income expectancy and the total property price or value.” Id. at 493.

There was substantial disagreement between the experts as to the overall capitalization rate. Plaintiff’s expert, having determined potential gross income on a gross income basis, loaded the tax rate into his final determination of overall capitalization rate. His base rate and loaded rates for each of the years under review are as follows:

Tax Year	Base Rate	Loaded Rate
2011	9.75%	12.35%
2012	9.5%	11.85%
2013	9.00%	11.85%
2014	8.5%	11.35%

Defendant’s expert calculated the overall capitalization rate on a net rent basis, thus excluding any tax rate and concluded as follows:

Tax Year	Overall Rate
2011	7.86%
2012	7.49%
2013	7.37%
2014	7.25%

Both experts utilized the Band of Investment technique, as well as a review of published capitalization data in determining an overall capitalization rate. The Band of Investment “technique is a form of ‘direct capitalization’ which is used to ‘convert a single year’s income estimate into a value indication.’ The technique includes both a mortgage and an equity component.” Hull Junction Holding Corp. v. Borough of Princeton, 16 N.J. Tax 68, 80-81 (Tax 1996), (quoting Appraisal Institute, The Appraisal of Real Estate 467 (10th ed 1992)).

Because most properties are purchased with debt and equity capital, the overall capitalization rate must satisfy the market return requirements of both investment positions. Lenders must anticipate receiving a competitive interest rate commensurate with the perceived risk of the investment or they will not make funds available. Lenders generally require that the loan principal be repaid through periodic amortization payments. Similarly equity investors must anticipate receiving a competitive equity return (i.e. equity capitalization rate) commensurate with the perceived risk, or they will invest their funds elsewhere.

[Appraisal Institute, The Appraisal of Real Estate 495 (14th ed 2013).]

When “using the Band of Investment technique, it is incumbent upon the appraiser to support the various components of the capitalization rate analysis by furnishing ‘reliable market data . . . to the court as the basis for the expert’s opinion so that the court may evaluate the opinion.’” Hull Junction Holding, *supra*, 16 N.J. Tax at 82 (quoting Glen Wall Assocs., *supra*, 99 N.J. at 279-80.) “For these purposes, the Tax Court has accepted, and the Supreme Court has sanctioned, the use of data collected and published by the American Council of Life Insurance.” Id. at 83. “Relevant data is also collected and published by . . . Korpacz Real Estate Investor Survey.” Id. at 83. “By analyzing this data, in toto, the court can make a reasoned determination as to the accuracy and reliability of the mortgage interest rates, mortgage constants, loan to value ratios, and equity dividend rates used by the appraisers.” Ibid.

1. Plaintiff's Expert

In his band of investment analysis for each year, plaintiff's expert reviewed the 3rd quarter American Council of Life Insurance (ACLI) surveys for 2010, 2011, 2012 and 2013 for loan to value and mortgage interest rates. In doing so, he specifically referenced information published for Industrial Properties in the \$2MM - \$4.99MM loan range and All Industrial Properties in the Middle Atlantic Region. In arriving at an equity dividend rate, the plaintiff's expert reviewed the average national equity dividend rate for U.S. industrial buildings in the 3rd quarters of each of the years which ranged from 11.09% in 2010 to 15.66% in 2013, as well as economic indicators for "safer" investments.

Based on the information reviewed, for each year under review he assumed a 20-year mortgage amortization period, a 10% equity dividend rate and a loan to value ratio of 60%. The mortgage interest rate assumption for each year was: 2011 – 5.75%; 2012 – 5.00%; 2013 – 4.5% and 2014 – 4.25%. The concluded capitalization rate under the Band of Investment method for each year was as follows: 2011 – 9.06%; 2012 – 8.75%; 2013 – 8.55%; and 2014 – 8.46%.

Plaintiff's expert then reviewed the RERC cap rate surveys for the 3rd quarter Warehouse – Eastern US – 3rd Tier and Korpacz 3rd quarter National Industrial Buildings – Non Institutional, and his conclusions under the Band of Investment method to reach a final base rate conclusion for each year of: 2010 – 9.75%; 2011 – 9.50%; 2012 – 9.00%; and 2013 – 8.50%.

As indicated above, plaintiff's expert then loaded the tax rate into his base rates to reach his final conclusions. The court will not consider plaintiff's loaded capitalization rates. The market rents were determined on a net basis, thus factoring in a tax rate is unnecessary. Humble Oil & Refining Co. v. Borough of Englewood Cliffs, 71 N.J. 401, 403-405 (1976). MSGW v. Mountain Lakes, *supra*, 18 N.J. Tax at 391 (1998).

2. Defendant's Expert

In reaching a conclusion as to the mortgage interest rates, loan to value ratios, and mortgage amortization period, the defendant's expert reviewed the 3rd quarter ACLI tables for All Industrial Properties, Industrial Properties with loans of less than \$2.0 MM and Industrial Properties in the Middle Atlantic Region; Realty Rates Investor Survey for Industrial Properties; and the local lending community for industrial properties.⁷ He also reviewed various rates of return for several classes of investments to arrive at an equity dividend rate of 9% for each of the years under review.

Based on the information reviewed, for each year under review he assumed a 25-year mortgage amortization period, a 9% equity dividend rate and a loan to value ratio of 70%. The mortgage interest rate assumption for each tax year was: 2011 – 5.50%; 2012 – 5.25%; 2013 – 4.75% and 2014 – 4.50%. The concluded capitalization rate under the Band of Investment method for each tax year was as follows: 2011 – 7.86%; 2012 – 7.49%; 2013 – 7.37%; and 2014 – 7.25%.

Defendant's expert also reviewed the ACLI Warehouse Capitalization Rates for the 3rd quarter of the valuation years in question.

Based on his review, he concluded that the overall capitalization rate for each of the tax years under review were those determined under the Band of Investment technique, i.e.: 2011 – 7.86%; 2012 – 7.49%; 2013 – 7.37%; and 2014 – 7.25%.

In supporting his conclusion, defendant's expert indicated that his results were more accurate in that he relied more extensively on the local market than on the national surveys plaintiff's expert relied on. The court notes that defendant's expert did not supply objective or factual evidence to support his contention regarding the local lending community. The court finds however that the objective data that defendant's expert relied on is more persuasive than that relied

⁷ Defendant's expert did not supply any specific information or testimony regarding the local lending community. When asked on cross examination to whom he spoke to determine local lending parameters, he responded that he "spoke to himself" as he was a member of the Board of Directors of a local bank and he knew the local market.

on by plaintiff's expert and that defendant's expert's conclusions as to the overall capitalization rate are supported by objective data. Thus the court accepts the defendant's expert's overall capitalization rate.

J. True Market Value

Accordingly, the court finds that the true market value of the subject property is as follows:

Determination of Net Operating Income

Potential Gross Income – 5,360 SF x \$11.50	\$ 61,640
Less Vacancy & Collection Loss Rate (8%)	(4,931)
Effective Gross Income	\$ 56,709
Less Brokerage Commission (5%)	(2,835)
Less Management Fee (2.5%)	(1,418)
Less Reserves (2%)	(1,134)
Net Operating Income	\$51,332

Determination of Market Value

	2011	2012	2013	2014
NOI	\$51,332	\$51,332	\$51,332	\$51,332
Cap Rate	<u>÷ .0786</u>	<u>÷ .0749</u>	<u>÷ .0737</u>	<u>÷ .0725</u>
True Value(R)	\$653,000	\$685,000	\$697,000	\$708,000

III. Conclusion

Having found true market value, the court must determine the correct assessment through the application of the Chapter 123 ratio to fair market value. See, N.J.S.A. 54:1-35a. The formula for determining the subject property's ratio is Assessment ÷ True Value = Ratio

Here, that equation is represented as follows:

Tax Year 2011:	\$828,900 ÷ \$653,000 = 1.269
Tax Year 2012:	\$828,900 ÷ \$685,000 = 1.210
Tax Year 2013:	\$828,900 ÷ \$697,000 = 1.189
Tax Year 2014:	\$828,900 ÷ \$708,000 = 1.171

Pursuant to N.J.S.A. 54:51A-6c, in a revaluation year, the assessed value of the subject property is its true value. Thus, since 2011 was a revaluation year, the assessed value of the overall property is its true value - \$653,000.

Pursuant to N.J.S.A. 54:51A-6b, if the average ratio is below the county percentage level (100%) and the ratio of the assessed value of the subject property to its true value exceeds the county percentage level, judgment is to be entered by applying the average ratio to the true value of the property. For tax year 2012, the average ratio was 95.09% and therefore the assessment of the subject property is $\$685,000 \times .9509 = \$651,367$.

Pursuant to N.J.S.A. 54:51A-6c, if both the average ratio and the assessed value of the subject property to its true value exceed the county percentage level, the tax court is to enter judgment revising the taxable value of the property by applying the county percentage level to the true value of the property. In both 2013 and 2014, the average ratio and the assessed to true value ratio of the subject property exceeded 100%. The county percentage level in those years was 100%. Therefore in 2013 and 2014 the assessed value of the property is:

2013 - $\$697,000 \times 100\% = \$697,000$
 2014 - $\$708,000 \times 100\% = \$708,000$

A judgment for tax year 2011 will be entered as follows:

Block 168 Lot 9.01

Land	\$263,936
<u>Improvements</u>	<u>264,994</u>
Total	\$528,930

Block 168 Lot 10.01

Land	\$ 89,330
<u>Improvements</u>	<u>34,740</u>
Total	\$124,070

A judgment for tax year 2012 will be entered as follows:

Block 168 Lot 9.01

Land	\$263,276
<u>Improvements</u>	<u>264,331</u>
Total	\$527,607

Block 168 Lot 10.01

Land	\$ 89,107
<u>Improvements</u>	<u>34,653</u>
Total	\$123,760

A judgment for tax year 2013 will be entered as follows:

Block 168 Lot 9.01

Land	\$281,720
<u>Improvements</u>	<u>282,850</u>
Total	\$564,570

Block 168 Lot 10.01

Land	\$ 95,350
<u>Improvements</u>	<u>37,080</u>
Total	\$132,430

A judgment for tax year 2014 will be entered as follows:

Block 168 Lot 9.01

Land	\$286,167
<u>Improvements</u>	<u>287,313</u>
Total	\$573,480

Block 168 Lot 10.01

Land	\$ 96,854
<u>Improvements</u>	<u>37,666</u>
Total	\$134,520

The Clerk of the court will enter judgment in accordance with this opinion.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Kathi F. Fiamingo". The signature is highly stylized and cursive, with a large, prominent loop at the end.

Kathi F. Fiamingo, J.T.C.