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THE TAX COURT COMMITTEE ON OPINIONS

TAX COURT OF NEW JERSEY

Patrick DeAlmeida
Presiding Judge



R.J. Hughes Justice Complex
P.O. Box 975
Trenton, New Jersey 08625-0975
(609) 292-8108 Fax: (609) 984-0805

May 14, 2013

David C. Keen
12 Two Penny Run
Pilesgrove, New Jersey 08098

Michael L. Moubert, Esq.
Greentree Executive Campus
4001 F Lincoln Drive West
Marlton, New Jersey 08053

Re: David C. Keen v. Township of Pennsville
Docket No. 011320-2011

Dear Mr. Keen and Mr. Moubert:

This letter constitutes the court's opinion after trial in the above-referenced matter. Plaintiff challenges the tax year 2011 assessment on commercial property he owns in Pennsville Township. For the reasons explained more fully below, the assessment is reduced.

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I. Findings of Fact and Procedural History

This letter opinion sets forth the court’s findings of fact and conclusions of law. R. 1:7-4.

Plaintiff David C. Keen is the owner of real property in defendant Pennsville Township. The property is designated by the municipality as Block 1303, Lot 24 and is commonly known as 234 N. Broadway. For tax year 2011 the property was assessed as follows:

Land	\$ 163,600
Improvements	<u>\$ 645,000</u>
Total	\$ 808,600

The Chapter 123 common level range for Pennsville Township for 2011 is 92.39%. The upper limit of the common level range is 100%; the lower limit of the common level range is 78.53%. The equalized assessed value of the property is \$875,203 ($\$808,600 \div .9239 = \$875,203$).

Plaintiff challenged the assessment before the Salem County Board of Taxation. On May 26, 2011, the board issued a Judgment affirming the assessment.

On July 7, 2011, plaintiff filed a Complaint in this court challenging the Judgment of the county board.¹

The subject property is an 11,625-square-foot, concrete-block commercial building constructed in 1943. The building sits on .77 acres and has an asphalt parking lot with space for 25 vehicles. The property is across the street from a shopping center on a busy road. The structure has three units. The owner, trading as Radio Shack, occupies the main unit, which is comprised of 6,625 square feet of space on two levels. The ground level has 3,250 square feet of finished retail space. The second level contains 3,375 square feet comprised of retail space, two

¹ Plaintiff owns the subject property with his spouse, Cynthia L. Keen. Mrs. Keen is listed on the Judgment of the Salem County Board of Taxation but is not included as a plaintiff in the Tax Court Complaint.

offices, a break room, a computer repair room, storage and two restrooms. This area of the building is in average condition.

Suite 1 is occupied by a tenant, OneMain Financial. This unit is 1,625 square feet of ground level, finished office space. The unit has an open office area, a private office, two file rooms, a storage room and a restroom. This suite is in good condition. The annual rent on this unit as of October 1, 2010, the valuation date, was \$15.24 per square foot. The tenant pays electric and gas; the owner is responsible for water and sewer charges. As of June 1, 2011, eight months after the valuation date, the lease was renewed at the same annual rent. However, because the tenant leased a larger area in the renewed lease, the rental rate became approximately \$10.00 per square foot.

The third unit at the property is a 3,375-square-foot, unoccupied, below-grade space. The lower level has painted sheetrock walls, concrete floors, and open truss ceilings. The area has a large open room, three private rooms, and a restroom. Because of water infiltration and the lack of a heating and air conditioning system, the highest and best use of this area is for storage.

Plaintiff presented the testimony of a real estate appraiser accepted by the court as an expert in valuing real property in New Jersey. He valued the subject property using both the income approach and the sales comparison approach. He ultimately opined that the subject property had a true market value of \$490,000 as of the valuation date. The details of the expert's valuation process will be discussed in greater detail below.

The municipality did not produce expert testimony, relying instead on its counsel's cross-examination of plaintiff's expert and the presumption of validity attached to the assessment.

II. Conclusions of Law

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 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)).

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). If the court determines that sufficient evidence to overcome the presumption has not been produced, the assessment shall be affirmed and the court need not proceed to making an independent determination of value. Ford Motor Co. v. Township of Edison, 127 N.J. 290, 312 (1992); Global Terminal & Container Serv. v. City of Jersey City, 15 N.J. Tax 698, 703-704 (App. Div. 1996).

The court concludes that plaintiff proffered sufficient evidence to overcome the presumption of validity attached to the county board judgment and assessment on the subject property. Plaintiff introduced expert testimony from a licensed real estate appraiser who offered

the opinion that the subject property had a true market value of \$490,000 on the valuation date. The expert used both the comparable sales approach and income approach to valuation. Each approach was based on data identified by the expert and each resulted in an opinion of value significantly below the equalized assessed value of the subject property. While the evidence on which the expert relied is, as in greater explained below, flawed, the court is required at this point in its analysis to give to the taxpayer every possible legitimate favorable inference from the evidence in the record.

The determination that the presumption of validity has been overcome does not end the court's inquiry. In light of the evidence produced by plaintiff, it is the court's obligation to determine the true market value of the subject property as of October 1, 2010, the valuation date for tax year 2011. "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.) (citing Appraisal Institute, The Appraisal of Real Estate 81 (11th ed 2006)), certif. denied, 168 N.J. 291 (2001). "There is no single determinative approach to the valuation of real property." 125 Monitor Street, LLC v. City of Jersey City, 21 N.J. Tax 232, 237 (Tax 2004) (citing Samuel Hird & Sons, Inc. v. City of Garfield, 87 N.J. Super. 65, 72 (App. Div. 1965); ITT Continental Baking Co. v. Township of East Brunswick, 1 N.J. Tax 244 (Tax 1980)), aff'd, 23 N.J. Tax 9 (App. Div. 2005). "The choice of the predominate approach will depend upon the facts of each case and the reaction of the experts to those facts." Id. at 238 (citing City of New Brunswick v. Division of Tax Appeals, 39 N.J. 537 (1963); Pennwalt Corp. v. Township of Holmdel, 4 N.J. Tax 51, 61 (Tax 1982)).

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 (Tax 1996). “In the income capitalization approach, an appraiser analyzes a property’s capacity to generate future benefits and capitalizes the income into an indication of present value.” Appraisal Institute, The Appraisal of Real Estate 445 (13th ed 2008). The court finds that the income capitalization approach is the best method for determining the value of the subject property, an income-producing building.

Under the income approach, plaintiff’s expert examined two sets of leases. He identified one set of four leases as comparable to the above-ground retail space at the subject property. He identified another set of four leases as comparable to the below-grade storage area at the subject property. The expert’s testimony and report, which was admitted as evidence, are significantly lacking in detail with respect to both sets of comparable leases.

The leases were identified by street address, year, size of leased area, rental rate and a one- or two-word description of use. No further information was provided. Copies of the leases or lease abstracts were not included in the report or reviewed by the expert. Nor were the parties to the leases identified, making it impossible for the court to determine if the lease transactions were the result of arms’ length negotiations. The expert had no knowledge of the circumstances of the lease transactions or the relationship, if any, of the landlord and tenant in each lease. It is also not possible to determine from the record if the comparable leases are net leases or gross leases, whether tenant improvements were included in the lease negotiations, or whether the leases contain graduated rent provisions.

The expert applied no adjustments to the comparable leases. There is, therefore, no expert testimony in the record addressing the impact on market rents resulting from the differences in the characteristics of the subject property and the comparable lease properties. The expert merely accepted the rents reported in the comparable leases as evidence of economic rent at the subject property.

All four of the retail space comparable leases are for buildings on North Broadway in Pennsville, the same street as the subject property. One of the four leases is the \$10.00 per square foot lease for Unit 1 at the subject property executed in June 2011, eight months after the valuation date. Two of the remaining comparable leases are identified as having been executed in 2010 and one as having been executed in 2011. The rents on the four retail space comparable leases were as follows: \$4.31 per square feet (office), \$4.29 per square foot (retail), \$9.60 per square foot (medical office) and \$10.00 per square foot (subject).

The expert testified that after considering these leases he determined that the market rent for the subject property's first floor, ground-level retail space was \$6.00 per square foot. In addition, he determined that the second floor retail space in the owner-occupied unit had a market rent of \$5.00 per square foot. He opined that the second floor space was less desirable due to the impact of steps on retail shoppers. He did not explain how he formulated his proposed market rents from the comparable lease rates. For example, the expert did not explain the relative weight he gave to each of the comparable leases in his analysis. Nor did he explain why the \$10.00 per square foot lease at the subject, executed shortly after the valuation date, was well above what he considered to be market rent for the subject. He also did not address the fact that on the valuation date the lease in place at the subject was for \$15.24 per square foot, more than

double the expert's opinion of market rent for the subject. The credibility of the expert's opinion on market rent for the retail space at the subject property is undermined by this omission.

Three of the four comparable leases for the storage space at the subject property were from the same building in Elmer, New Jersey. Elmer is approximately a 35-minute drive from Pennsville. The Elmer leases are all from 2008, two years prior to the valuation date. The expert made no time adjustment to the rental rate in those lease. The fourth storage space comparable lease is from 2010 in Pennsville. As was the case with the retail comparable leases, the expert made no adjustments to the storage space comparable leases. The storage space comparable leases had the following rents: \$4.21 per square foot (garage/warehouse); \$5.16 per square foot (garage/warehouse); \$5.80 per square foot (garage warehouse); and \$4.82 per square foot (garage/warehouse). After considering these leases, the expert determined that the below-grade storage area had a market rent of \$3.00 per square foot. This figure is below all of the comparable leases identified by the expert. The expert explained that the subject property's storage area was inferior to all of the comparable leases because the only access to the space was through a narrow door and down steps, providing inferior access, and because the subject property had low ceiling heights. The comparable leases were of ground level storage areas with roll-up doors, providing easier access for storage.

Applying the market rental rates he selected, the expert calculated potential gross income of \$56,250 for the subject property $((4,875 \text{ square feet} \times \$6.00) + (3,375 \text{ square feet} \times \$5.00) + (3,375 \text{ square feet} \times \$3.00) = \$56,250)$. The expert then applied a 7.5% vacancy and collection loss rate, resulting in effective gross income of \$52,031 $(\$56,250 \times .925 = \$52,031)$. The market data supporting the vacancy and collection rate was not identified by the expert. He provided no testimony with respect to the vacancy rate at any of the properties that are the

subject of the comparable leases. Nor did he account for the vacancy history of the subject. The expert thereafter opined that the tenants would be responsible for all utilities, property taxes and insurance. He did not explain why this would be so, despite the subject property's history of having the landlord pay water and sewer charges. The expert then deducted expenses for management, maintenance and reserves of 12% of effective gross income. Again, the expert identified no market data to support these deductions, which amounted to \$6,244 ($\$52,031 \times .88 = \$45,787$).

To the \$45,787 in projected net operating income the expert applied a 9.5% capitalization rate he derived from applying the band of investment technique. Application of the 9.5% capitalization rate to the projected net income resulted in a value of \$481,968 ($\$45,787 \div .095 = \$481,968$). He rounded this figure to a value of \$480,000.

Because the expert made no adjustments to the comparable leases upon which he relied, his opinion of value lacks credibility. The record contains no evidence on which the court can meaningfully compare the comparable properties to the subject property. Without appropriate adjustments, the comparable lease rates do not provide credible evidence of the appropriate market rent for the subject property. For example, no adjustments were made for time, location, parking, building condition, customer access, tenant improvements, or any other characteristics of the properties that may have an impact on rental rates. The lack of adjustments is highlighted by the fact that a lease at the subject property was executed shortly after the valuation date for a rental rate almost twice what the expert opined as market rent for the subject. The expert provided no testimony explaining why plaintiff was able to secure an above-market rent for Suite

1 at the subject. There is simply too little support in the record for the expert's proposed economic rent for the retail space at the subject property.²

To determine the true market value of the subject property on the valuation date, the court will apply the \$10 per square foot rental rate in the lease for Suite 1 at the subject property negotiated shortly after the valuation date. With no evidence in the record that plaintiff negotiated an above-market lease for Suite 1, the court concludes that the \$10 rental rate is the best evidence in the record of market rent for the subject and is sufficiently reliable for determining value. This approach gives the benefit of the doubt to plaintiff, as the court could reasonably conclude that the \$15.24 per square foot lease in place for the subject property on the valuation date constitutes market rent as of the valuation date. Nothing in the record supports a reduction in the rental rate for the second floor retail space. As a result, the court will apply a \$10 per square foot rental rate to the entire retail space. The court will accept the storage space rental rate, vacancy and collection rate, management, maintenance and reserve deduction rate, and capitalization rate proposed by plaintiff's expert.

² Plaintiff's expert also relied on the comparable sales approach. See Appraisal Institute, The Appraisal of Real Estate, 419 (12th ed 2001)(the comparable sales approach "usually provides the primary indication of market value in appraisals of properties that are not usually purchased for their income-producing characteristics."). This method of valuation has been defined as "[a] set of procedures in which a value indication is derived by comparing the property being appraised to similar properties that have been sold recently, applying appropriate units of comparison, and making adjustments to the sales prices of the comparables based on the elements of comparison." Id. at 417. The court declines to apply the sales comparison approach to determine the value of the subject property for two reasons.

First, because of the property's income-generating history and potential the court concludes that the income approach is the most appropriate method for determining true value in this case. Second, the comparable sales identified by plaintiff's expert are not credible. The expert conceded that one of the five comparable sales he identified was the result of a foreclosure and could properly be characterized as "distressed." He acknowledged that a second comparable sale was a short sale. He did not verify three other comparable sales as arms' length transactions and had obtained no information with respect to the financing of any of the transactions.

Applying these conclusions, the potential gross income of the property is \$92,625 ((8,250 square feet x \$10.00) + (3,375 square feet x \$3.00) = \$92,625). A 7.5% vacancy and collection rate results in effective gross income of \$85,678 (\$92,625 x .925 = \$85,678). A 12% deduction for management, maintenance, and reserves results in effective gross income of \$75,397 (\$85,678 x .88 = \$75,397). Application of a 9.25% capitalization rate results in a true market value of \$793,700 (rounded) (\$75,397 ÷ .095 = \$793,653).

Pursuant to N.J.S.A. 54:51A-6a, commonly known as Chapter 123, in a non-revaluation year an assessment must be reduced when the ratio of the assessed value of the property to its true value exceeds the upper limit of the common level range. The common level range is defined by N.J.S.A. 54:1-35a(b) as “that range which is plus or minus 15% of the average ratio” for the municipality in which the subject property is located.

The true value determined above must, therefore, be compared to the common level ratio for Pennsville Township for tax year 2011. The formula for determining the subject property’s ratio is:

$$\text{Assessment} \div \text{True Value} = \text{Ratio}$$

$$\$808,600 \div \$793,700 = 1.02$$

The chapter 123 common level ratio for Pennsville Township for tax year 2011 is .9239. The upper limit of the common level range is 100% and the lower limit of the common level range is .7853. The ratio for the subject property for this tax year is 1.02, which exceeds the upper limit of the range for this tax year.

According to N.J.S.A. 54:51A-6b “[i]f the average ratio is below the county percentage level and the ratio of the assessed value of the subject property to its true value exceeds the

county percentage level, the tax court shall enter judgment revising the taxable value of the property by applying the average ratio to the true value of the property.”

Here, the average ratio, 92.39%, is below the county percentage level of 100%. In addition, the ratio of the assessed value of the subject property to its true value exceeds the county percentage level of 100%. The court, therefore, will revise the taxable value of the property by applying the average ratio to the property’s true value: $\$793,700 \times .9239 = \$733,300$.

The court will enter Judgment revising the assessment on the subject property as follows for tax year 2011:

Land	\$ 163,600
Improvements	<u>\$ 569,700</u>
Total	\$ 733,300

Very truly yours,


Patrick DeAlmeida, P.J.T.C.