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THE TAX COURT COMMITTEE ON OPINIONS

TAX COURT OF NEW JERSEY

Mala Sundar
JUDGE

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Re: Rozinante, Inc. v. Borough of Sea Bright
Block 23, Lot 13
Docket No. 001307-2016

Dear Counsel:

This opinion addresses the reasonableness hearing held as required by Ocean Pines Ltd. v. Borough of Point Pleasant, 112 N.J. 1 (1988) after the court dismissed the complaint under N.J.SA. 54:4-34 (commonly known as "Chapter 91"). Plaintiff proffered testimony of the defendant's assessor and from a member of the revaluation company, which had been retained to perform a district-wide revaluation for defendant ("Borough") as proof that the data and methodology underlying the assessment imposed on the above-captioned property ("Subject") for tax year 2016 was unreasonable.

The assessor, who is employed as such in the Borough since 1995, stated that he was familiar with the seven existing beach clubs in the Borough, their amenities, construction quality,

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whether they were public or private memberships, and the like. He was also familiar with the Chapter 91 process and had sent Chapter 91 requests in prior years to the major income-producing properties, including the beach clubs. He affirmed that he had received responses to his Chapter 91 requests from the beach clubs in the past.

The assessor agreed that for tax year 2016, the revaluation company sent out the Chapter 91 requests on his behalf. Since it was a revaluation, the assessor did not inspect any property including the Subject. He however communicated with the revaluation company throughout in connection with the assessments to be imposed on the beach clubs, including the Subject. He provided all information he had on the beach clubs to the revaluation company since he had inspected each one of them post Superstorm Sandy, was familiar with their reconstruction information including permits, and had adjusted their assessments in this regard.

The assessor stated that he examined a spreadsheet prepared by the revaluation company at his request as a "comfort level" check since they were the highest rateables in the Borough. The spreadsheet had 24 columns itemizing, among others, the beach club's name; property identification; whether membership is public or private; lot size; improvement size; number of cabanas and lockers; area of ocean frontage; whether it was owned or leased; rent; business income; land value; improvement value; comments. Five of the seven beach clubs were denoted as "owner," one beach club, Ship Ahoy, was denoted as "leased," and one beach club, Chapel, was denoted as "leased?" Only one beach club, Sea Bright, was private.

The assessor stated that while he felt the suggested values were relatively appropriate, he had some concerns with the figures, therefore reached out to the Monmouth County Board of Taxation's Tax Administrator for his input. He provided the spreadsheet to this individual and later met with him to go over the information. The Tax Administrator agreed that the values suggested

by the revaluation company were reasonable although the assessor had no knowledge of the Tax Administrator's reasons or thought processes for the same. With the agreement of the Tax Administrator, the assessor felt comfortable in using those values.

In his prior deposition (in connection with the instant reasonableness hearing), the assessor had stated that he had also relied in part on a May 2013 sale of vacant land in Monmouth Beach, where he is also the assessor, of oceanfront property for residential use to confirm the value conclusion for the Subject. He testified in court that this sale was marked as usable, and he tested it with the land value conclusion for the Subject. Since beach clubs have larger lots, thus, lower price per-acre, he stated that he felt the land value allocated to the Subject ($5,308,800) was reasonable, and the assessment, as a whole, reflected the Subject's fair market value. He therefore approved the Subject's assessment.

The assessor stated that he had used the valuation numbers for the Subject as suggested by the revaluation company in the preliminary and final tax list. The assessment did not change between those dates. He was not aware of 100% of the data and methodology for each allocated component of the assessment that was used by the revaluation company, however, he knew data were used such as physical characteristics, tax map usage, area measurement, and data available on the CAMA database. He was familiar with Ship Ahoy, an adjacent beach club, and did not know of its lease (which was used in setting the Subject's assessment) when the assessment for the Subject was imposed. He knew of the lease only when informed by the revaluation company (post-assessment) and was unaware of the property owner or the nature of the lease.

The member of the revaluation company who testified is a general real estate appraiser since 1986 and a member of the Appraisal Institute. He was familiar with Chapter 91 requests and responses having reviewed several of them. In a revaluation, his personal responsibilities include

inspecting properties, concluding values, and suggesting assessments. In the instant matter, he was assisted by inspectors as to valuation conclusion for the improvements but he personally arrived at the land value. He also did not personally discuss his value conclusions with the assessor, however, this was done by his brother, another member of the company. He stated that he has appraised every beach club in Monmouth County.

He testified that a "cursory" search for comparable sales of beach clubs had yielded no data. He therefore used an income approach based upon the income and expense information reported on Ship Ahoy's Chapter 91 response (since there was no such response from the Subject). He used the land value he had concluded for Ship Ahoy for the Subject also, however, used an independent cost approach to value the Subject's improvements.

Ship Ahoy's Chapter 91 response showed base rent was $800,000 annual plus "profit share" of $175,000. He capitalized the entire $975,000 under an income approach. He testified that the profit sharing appeared to be akin to a percentage rent, to be paid in addition to the base rent, therefore, was appropriately included for deriving the income from the property. He used a 5% vacancy factor, deducted a certain amount of operating expenses, and thereafter capitalized the net operating income at 8%. He testified that the capitalization rate was slightly on the higher side, however he had derived the same from market data of interest rates and equity return yields between 6-8% for other commercial properties. However, he conceded that when deposed, he had stated that he used 8% because there was no published data for capitalization rates for beach clubs.

He then subtracted the contributory value of the improvements to extract a land value for Ship Ahoy's two lots (a riverfront lot for the beach club and an oceanfront lot for surface parking). He reduced the same by $1,000,000 since, in his opinion, the indicated land value was at the high end of the range and would yield too high a per-acre value. He also depreciated for the presence

of a sea wall impacting usability at 20% based on past appraisal practice despite the wall's diminished impact on value since the more recent practice of beach replenishment. With these reductions, he concluded a land value of $1,200,000 per-acre, which he also used for the Subject. He stated that the Subject's lot was comparable in size and location to Ship Ahoy's lot on which the beach club was located, however, did not possess a similar riverfront, therefore, he made a reduction from land value for this factor.

He agreed that he did not rely on any data other than the Chapter 91 information from Ship Ahoy for a conclusion of the land value for the Subject. He stated that a mass appraisal employed for district-wide revaluations are narrower in scope and less expensive compared to an assignment of appraising an individual property, which is more expensive due to the singular attention paid to each detail of each aspect of an appraisal assignment and requiring production of an appraisal report.

When questioned as to why he did not use the rental information from another beach club, Chapel, he stated that the lease was suspect as being between related parties. However, he claimed, he had no reason to believe the same for Ship Ahoy especially since he did not have a copy of the lease at any time until this litigation. He opined that when he had perused the lease for purposes of the reasonableness hearing, although the signatures on the lease evidenced there were related parties, he would not have immediately concluded the same non-usable as between related parties due to certain terms in the agreement, but could not recall the details in this regard. He did not reach out to anyone in Ship Ahoy to confirm whether there was a lease and whether the lease was between related parties.

Plaintiff urged the court to find the assessment unreasonable based on issues in the methodology and data used by the revaluation company. The flawed methodology was purported

use of an extraction method for land value, which did not match the recommended land residual method in the Appraisal of Real Estate treatise which requires both building and land capitalization rates be extracted from the market. Extraction cannot be accomplished by working backwards.[1]

The underlying data was suspect because, per plaintiff, (1) the data was admittedly limited, increasing the risk of arbitrary assessment; (2) five of seven clubs are owner-occupied, yet no investigation was done as to the nature of the Ship Ahoy lease information used to set the assessment for the other clubs; (3) the lot size was for the Subject was increased from 4.4 acres as sown on the tax map to 5.53 without explanation; (4) the capitalization rate was not market-driven; (5) the quantum of the $1,000,000 reduction itself confirms that the value conclusion was problematic; (6) the $175,000 shown as profit-sharing indicates that business income was used in the income analysis, rather than solely rental income; (7) the depreciation of the sea wall remained constant over thirty years despite a reduced impact on usability of the land.

Plaintiff argued that in aggregate, these issues render the assessment unreasonable, and the court cannot have any confidence that the value placed on the Subject was reasonable. Due diligence would require more investigation to avoid an arbitrary or capricious assessment. Further, it contended, the fact that plaintiff did not supply more information should not justify the reliance on limited data supply as reasonable.

The Borough disputed the relevance of the revaluation company's methodology and data because the scope of a reasonableness hearing is limited to the methodology used by and data available to the assessor at the time the assessment is set. To the extent this evidence can be considered, the Borough pointed out that (1) the revaluation company was limited to use available

[1] Plaintiff contended that only the value allocated to the land was arrived at unreasonably.

information due to the plaintiff's failure to provide a Chapter 91 response; (2) the assessor, the key person in a reasonableness context, never had a copy of Ship Ahoy's lease at the time he imposed the assessment; (3) the assessor acted more than reasonably before adopting the revaluation company's valuation suggestions; and (4) even if the assessment was incorrect or did not meet best practices, it is not automatically unreasonable for purposes of a reasonableness hearing.

ANALYSIS

In Ocean Pines, supra, the Supreme Court interpreted N.J.SA. 54:4-34 which provides that a failure or refusal to timely respond, or provision of a false or fraudulent response, to a Chapter 91 request (1) bars an appeal "from the assessor's valuation and assessment" of an income-producing property, and (2) requires the assessor to "value" such property "at such amount as" the assessor may "reasonably determine to be [its] full and fair value," based upon any "information" available to the assessor.

The Court held that by using the word "reasonably," a taxpayer could still be entitled to some remedy if it can be shown that the assessor "unreasonably valued the property." Ocean Pines, supra, 112 N.J. at 11. However, "any such appeal is sharply limited in both its substantive and procedural aspects." Ibid.

Substantively, the appeal "is limited in its scope to the reasonableness of the valuation 'based upon the data available to the assessor.'" Ibid. (citation omitted). Thus, a taxpayer cannot use any "financial information" it had failed to provide in response to the Chapter 91 request. Ibid.

> The inquiry will focus solely on whether the valuation could reasonably have been arrived at in light of the data available to the assessor at the time of the valuation. Encompassed within this inquiry are (1) the reasonableness of the underlying data used by the assessor, and (2) the reasonableness of the methodology used by the assessor in arriving at the valuation.
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> [Ibid.]

Discovery is therefore curtailed to "any information relied on by the assessor in arriving at the . . . valuation." Id. at 12. However, if expert opinions are proffered, then such opinions are discoverable. Ibid.

Procedurally, the appeal should ideally be decided in a "summary" fashion, i.e., not as a "plenary hearing" and without the need for "testimony," due to the "limited scope of inquiry." Id. at 11-12. Thus, a reasonableness hearing can be disposed of similar to a summary judgment motion. See R. 4:67-5 (if "affidavits show palpably that there is no genuine issue as to any material fact, the court may try the action on the pleadings and affidavits, and render final judgment," however, if there are "genuine issue[s] as to a material fact," then the court must "hear the evidence as to those matters," before issuing its judgment). Regardless, the hearing "does not include plenary proofs as to the value of the property under appeal but only proofs as to whether the assessment imposed by the assessor was reasonable." Lucent Technologies, Inc. v. Township of Berkeley Heights, 24 N.J. Tax 297, 308 (Tax 2008).

The burden is upon the taxpayer to prove the unreasonableness of the assessment, which assessment's presumptive correctness must be overcome by evidence that is "definite, positive and certain in quality and quantity." Ocean Pines, supra, 112 N.J. at 12 (citations omitted); see also Lucent, supra, 24 N.J. Tax at 308 ("in the context of a reasonableness hearing, the data upon which the assessor relied and the assessor's methodology are presumed to have been reasonable."). Proof of an unreasonable assessment by the required standard of evidence must show "that in selecting the data, the assessor acted arbitrarily or capriciously or that the methodology used by an assessor was arbitrary or capricious." Id. at 311. This standard of review "is less stringent than the standard applicable in the context of a plenary valuation hearing for purposes of determining whether a

presumption of validity attaches to an assessment." Id. at 312.[2] This is because the Chapter 91 statute "requires only that the assessor 'reasonably determine' the value of a property" based upon information available to the assessor, regardless of "whether a particular property is 8% or .008% of the total tax base." Ibid. (quoting N.J.S.A. 54:4-34).

Thus, a taxpayer has failed to prove arbitrary or capricious assessment although the property was not inspected, and the assessor relied upon past information in the files without verifying the same, and without researching or using current market data. Id. at 311. The court noted that while these flaws would be deficient in the context of "standards applicable to appraisal of the property under USPAP or under court decisions discussing the adequacy of appraisal analyses," they did not prove an unreasonable basis for an assessment for purposes of Chapter 91. Id. at 311-13; see also 510 Ryerson Rd., Inc. v. Borough of Lincoln Park, 28 N.J. Tax 184, 196 (Tax 2014) (assessment not unreasonable even if assessor did not "independently verify" information on rents and did not personally inspect the property, and adopted the values recommended by the revaluation company based on an income approach); Waterside Villas Holdings, L.L.C. v. Township of Monroe, 2012 N.J. Tax Unpub. LEXIS 22 (Tax 2012) (rejecting an argument that "an assessment based on a valuation using the income approach is unreasonable and arbitrary if the assessor cannot demonstrate that he reviewed market rents at the time of the assessment" for purposes of a reasonableness hearing), aff'd, 434 N.J. Super. 275 (App. Div. 2014).[3]

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2 This ruling comports with the general principal in the application of the "arbitrary and capricious" standard of review by the courts. See D'Atria v. D'Atria, 242 N.J. Super. 392, 401 (Ch. Div. 1990) ("The arbitrary or capricious [or unreasonable] standard calls for a less searching inquiry than other formulas relating to the scope of review . . . [and] is the least demanding form of judicial review."). A decision "is not arbitrary, capricious, or unreasonable whenever a Court can review the reasons stated for the decision without a loud guffaw or involuntary gasp." Ibid.

3 Although the Tax Court opinion was unpublished, it was affirmed in a published opinion of the higher court. See 434 N.J. Super. at 279 (denying consideration of plaintiff's contention that "THE DATA AND METHODOLOGY

The court here finds that neither the assessor nor the revaluation company acted arbitrarily or unreasonably in selecting data and employing an assessment methodology. Plaintiff did not provide any information to show that there was overwhelming market data on valuation of beach clubs which either the assessor or the revaluation company ignored. The assessor's familiarity with the beach clubs in the Borough, his knowledge of a vacant land sale vis-à-vis adjustment for economies of scale for the larger beach club lots, his discussions with the revaluation company about the values for the beach clubs, and the additional steps he undertook to ensure that the values suggested by the revaluation company were reasonable, show anything but a total disregard for how an assessment should be imposed.

The revaluation company's member also acted reasonably in selecting its data and employing its assessment methodology (plaintiff critiques only the methodology for valuing the land component of the assessment). He was undisputedly familiar with beach clubs. He reasonably relied upon the Chapter 91 response of Ship Ahoy to set the land value of the Subject since that beach club was similar to the Subject in terms of lot size and location (except for the absence of river-frontage), an opinion undisputed by plaintiff. His adjustments ($1,000,000 discount and 20% depreciation for sea wall) were based on his opinion and experience, and do not convert the reductions or the ensuing valuation unreasonable. Unlike the case in Transcontinental Gas Pipe Line Corp. v. Township of Bernards, 111 N.J. 507 (1988), the adjustments were not designed to get a tax result.

The court disagrees with plaintiff that the revaluation company should have known that the lease in Ship Ahoy was among related parties, thus, suspect, since it had rejected use of another

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USED BY THE MONROE ASSESSOR WERE ARBITRARY AND CAPRICIOUS AND THE RESULTING ASSESSMENT WAS UNREASONABLE," and affirming "essentially for the reasons set forth by Judge Menyuk in her well-reasoned written opinion dated December 28, 2012").

beach club's lease for this reason. Such an assumption, i.e., assuming all leases for beach clubs are non-arm's length since they are all inevitably between related parties, would actually lend to an arbitrary action. The court is also unpersuaded by plaintiff's argument that the revaluation company failed to exercise due diligence because it did not ask Ship Ahoy for its lease, and did not verify that lease. The Chapter 91 statute does not mandate the assessor to follow up on Chapter 91 responses. Further, the Chapter 91 request is signed under penalties of perjury. There was nothing on Ship Ahoy's Chapter 91 response that indicated that the rental amounts are suspect, and the lease evidences the same since it is between related parties. Therefore, there was no reason for the assessor or the revaluation company to disregard the information provided on the Chapter 91 response. Additionally, since the properties in the Borough were the subject of a mass-appraisal pursuant to a district-wide revaluation, the revaluation company did not flout any requirements of due diligence or professional responsibility in seeking out Ship Ahoy's lease. Therefore, neither the assessor (nor here, the revaluation company), acted unreasonably by failing to request Ship Ahoy's lease. Keeping the Ocean Pines ruling in perspective, the inquiry is limited to the reasonableness of data and methodology used with regard to the information "available to the assessor at the time of the valuation." 112 N.J. at 11.

What plaintiff emphasizes as a "red flag" in the Chapter 91 response, viz., the $175,000 "profit sharing," that should have, but did not stop the revaluation company in its tracks, is not. The Chapter 91 response reflected $175,000 as "escalation income." The same amount was reflected in column 8 of Schedule A to the response titled "Escalation Income." In Section 2 of that same Schedule titled "Other Income," $175,000 was shown as "Profit Share -2014." It was therefore entirely reasonable for the revaluation company to consider, as was testified, that the $175,000 was part of the rental income. Indeed, it could be posited that he considered, but

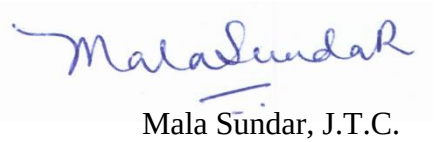
excluded, the additional $175,000 shown as "other income," since he only included what was reported as escalation income.

Finally, the court agrees with the Borough that the absence of objective market data for capitalization rates for beach clubs, lot size discrepancies, or the validity of an extraction method, may be appropriate to attack the credibility of an expert's value conclusion in a regular trial of a tax appeal. However, these factors simply do not rise to the level of either the data or the methodology as being selected and/or used in an arbitrary, capricious, or unreasonable manner, for purposes of a Chapter 91 reasonableness hearing, as precedent has firmly established. A flawed or incorrect assessment is not automatically baseless under the "arbitrary or capricious or unreasonable" review.

CONCLUSION

The court finds that neither the assessor nor the revaluation company acted arbitrarily or capriciously in their data selection and assessment methodology to base the Subject's 2016 assessment. Plaintiff's complaint is therefore dismissed.

Very Truly Yours,



Mala Sundar, J.T.C.