

Tax Appeal Strategies In A Real Estate Down-Turn



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The readers of this magazine are well aware that New Jersey generates most of its operating revenue from real estate taxation. Now that the real estate bubble has burst, what measures can be taken to minimize the adverse effects of a marketplace predominated by distressed and depreciating values?

The current real estate environment is ripe for assessment inequities: 1) a volatile real estate marketplace exists; 2) assessors cannot make the corrections that need to occur when handcuffed by existing legal and regulatory restrictions; 3) overburdened Tax Court and County Boards are forced to make decisions based upon meager evidence of actual market values; and 4) parties inevitably enter into imprudent settlements that do not accurately reflect true value. As a result, there may be an increasingly fragmented deviation between assessed values and true values under appeal versus those property assessments that have not been challenged by appeal.

Credibility demands increased vigilance towards maintaining accurate and uniform market value based assessments on an annual basis throughout the state. If maintenance reassessments were the norm in an appreciating market, credibility with taxpayers must be maintained by continuing these reassessment practices in a depreciating marketplace. If revaluations have not recently occurred, the up-tick and now downtick of a ballooning and bursting market may create a disparity between values of property and their assessments.

The Division of Taxation's normal historic averaging of useable sales over an unusually violently fluctuating marketplace to calculate Common Level Ranges and Average Ratios have made deviant assessments the norm rather than the exception. By way of example, a three-year average of sales in most taxing districts would include a larger number of appreciably higher sales with higher values in earlier years due to a lack of sales in the more recent depreciating marketplace.



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resulted in even more lawsuits and workers compensation claims as employees attempt to use the legal system to protect themselves from losing their jobs. Certainly, all municipalities must continue to significantly improve their personnel practices. However, the Legislature must also address abuses in the current legal system.

Attorney Fees The basic problem is attorney fee shifting. In most liability cases, the claimant's attorney is paid from the award and the fee is capped at between 25 percent and 33 percent, depending on the size of the judgment. However, under the Civil Rights Attorney's Fees Award Act of 1976, the defendant must pay a prevailing claimant's attorney fees as determined by the court, and there is no cap.

In Federal court at the end of a trial, the judge determines an appropriate hourly rate based on statements from other attorneys about the current going rate. Of course, these statements tend to exaggerate the number. For example, the fee usually awarded today is between \$300 and \$350 per hour, or about double what most defense attorneys make. New Jersey goes a step further and awards an "enhancement," ordinarily between 5 and 50 percent, to compensate the claimant's attorney for the risk that the case is unsuccessful. The courts have ruled that the typical enhancement should range between 20 and 35 percent. As a result, New Jersey courts usually award plaintiff attorneys \$350 to \$475 an hour if they win.

This system encourages attorneys to waste time in endless depositions and to make unreasonable demands to stretch out the proceedings and build up the fees, especially if the case has any merit. For example, in one lawsuit, a police chief was accused of harassing his secretary. Efforts to settle the case proved impossible because the secretary's attorney insisted on two million dollars. The jury awarded the secretary only \$25,000 for mental anguish and \$350,000 for past and future lost wages. On the surface, the jury's decision appears to be a favorable result for municipality.

Here is the bad part. If this were a regular liability case, the employee's attorney would have received \$125,000. If this was in Federal court, the attorney would have received

\$500,000. However, because the case was filed in New Jersey state court, the judge awarded the employee's attorney just short of \$900,000, or 2.4 times the amount the jury awarded the employee, despite the fact that the employee's attorney refused to make a reasonable settlement demand.

NEW JERSEY LOCAL GOVERNMENT IS FACING AN EXPLOSION OF LAWSUITS THAT IS WASTING TENS OF MILLIONS EACH YEAR.

It gets worse. Under Title 59, New Jersey public entities cannot be sued for punitive damages. However the court has ruled that public entities and officials are liable for punitive damages in civil rights cases when upper management had "actual participation in or willful indifference to the wrongful conduct." In civil rights cases, the cap in New Jersey's Punitive Damages Act doesn't apply. Further, punitive damages cannot be covered by insurance or indemnification ordinances. If you are sued for punitive damages, you're on your own. You can't even avoid a punitive damage award by declaring bankruptcy.

As a result, employment attorneys all over the state are taking relatively minor employment cases in hopes of making a big payday at the taxpayer's expense. The legal profession calls this "winning the lottery." Lawyers take courses on how to win big fees and how legal costs now account for almost two thirds of the total spent on these claims.

Public entities are especially vulnerable to these lawsuits. Forty-two percent of all employment related cases are against governmental units. In municipalities, 64 percent of employment lawsuits are filed by law enforcement personnel. Recent court decisions have also expanded what is considered as harassment. As a result, the frequency and cost of this litigation has made some towns and police departments virtually uninsurable.

Changing Conduct Standards The New Jersey Supreme Court has rightfully sent a strong message to all local governmental officials—personnel practices must be upgraded to prevent harassment and other workplace wrongdoing or you will be sued. Simply, many common attitudes of the past must change and the old fashioned patrol room, garage or office "give and take" can no longer be condoned. Behaviors that were tolerated 10 or twenty years ago are no longer acceptable. Employees have a right to a safe work place free of harassment and discrimination and are not afraid to resort to the courts to defend these rights.

This fall, the MEL is distributing an updated model personnel policies and procedures manual that can be downloaded from our web site (njmel.org). We are also distributing a separate anti-harassment training program for managers, employees and volunteers, including a new video. Copies are available on disc and online. It is critical that you bring your community into compliance with the court mandate as quickly as possible. No tolerance of workplace wrongdoing must mean exactly that.

Class Action Suits In the past few years, attorneys have also started filing class action suits against local public entities. In one notorious case, attorneys started a class action against almost every town in the state alleging that they were charging the wrong amount for copies of police reports. This litigation was prompted by the legislature including a fee shifting provision in OPRA. At the end of the day, this petty squabble cost the tax payers over one million dollars.

The lawsuit explosion will continue so long as attorneys are able to win disproportional fees. Legislation is needed to cap attorney's fees similar to other types of liability cases. Legislation is also needed to end punitive damages against public entities and curb class actions. Unfortunately, the current legal system has become a bonanza for attorneys and encourages endless litigation. While employees and others injured by the actions of government should have redress to the courts and should be compensated for harassment and discrimination, the current system really benefits attorneys far more than wronged individuals. •

According to the assessing community, one law enacted during the appreciating real estate market, Chapter 101 (N.J.S.A. 54:4-23), now stifles the ability of assessors to promote equity and the ability to accurately reflect large differences between different segments of the marketplace. A changing marketplace requires that assessors be afforded greater flexibility in maintaining their assessments. This law sought to address an issue in an extraordinarily unusual marketplace with soaring values. The assessing community believes that current market conditions require a greater degree of flexibility for assessors to make changes to classes of property assessments than currently permitted under this law.

In this past year, a substantial increase in tax appeal filings has burdened our Tax Court and Boards of Taxation. As a result of this increase in tax appeal filings, delays will inevitably occur prior to hearings of cases on the merits. The Tax Court and Boards will press settlements. Many County Tax Boards have been overwhelmed this year. The Tax Court is currently experiencing a backlog of cases. Trial dates are being scheduled 24 months, if not longer, from filing.

How will this backlog of cases affect the strategies of litigants and, in particular, the defense of tax appeals by municipalities? On the one hand taxpayers may have an increased desire to settle cases in order to avoid waiting an unusual long period of time for a trial date. But, it may be just as likely that

taxpayers will rather wait to have their "day in court."

The administrative difficulties from the increased volume of appeals is exacerbated by the fact that in residential properties there is a lack of evidence of usable comparable sales and inadequate proofs as to what is the true value of any given home. In many municipal taxing

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districts, few if any comparable homes have sold to provide evidence to assist County Board Commissioners and Tax Court Judges alike. Some appraisers are providing testimony on incomplete sales from multiple listing services, and even relying upon distressed sales as comparables. Comparable sales are good evidence when a typically motivated seller and buyer have brought the transaction to a conclusion. Unusually motivated

sellers, such as a Seller of a property in foreclosure, or after a short sale are not typically usable as comparable in a tax appeal scenario without evidence of complete exposure to the marketplace. The Division of Taxation in development of the Average Ratio does generally not consider these sales. However, in a number of municipalities, assessors have expressed a concern that they may be faced with the dilemma of marking unusable a significant portion of the market constituting previously impaired distressed sales.

In the area of commercial income-producing property tax appeals, taxpayers and municipalities are faced with an unusual, and some may say bizarre, factual scenario. It is generally understood that there is a downturn in the marketplace. However, that market inactivity, coupled with low capitalization rates, may make it increasingly difficult for appraisers and decision makers alike to come to an accurate opinion and determination of assessed values.

In the last few years, appraisal experts have been reluctant to rely upon extraordinarily low capitalization rates in their appraisals. Sales during the same period of time, however, cannot be explained without using low capitalization rates. Actual sales often cannot be accounted for when analyzed using a conservative income capitalization approach in the appraisal of the same property. Some appraisers may explain these differences by comparing fee simple appraisals (required in real estate

taxation) with leased fee appraisals (used by purchasers of a building with a rent revenue stream). The undesirable result is that wide fluctuations in opinions of value may end up being proven in these unusual times. As the old legal adage goes, bad facts make bad law, and in these times, bad facts may make bad assessments.

As the market begins to correct itself with more activity, the resulting evidence may strongly impact the ability of municipalities to defend their ratables in appeals. In the intervening period of time, an aggressive defense of tax appeals is needed. This will require the assessor, the municipal attorney, and the municipal appraisal expert, to carefully research comparable sales utilized by tax appellants. The assessing community lacks an accurate database for determining income-capitalized values. Assemblage of a database using income and expense reports within similar markets across municipal boundaries should be encouraged if not formalized by county or state resources. The assessing community's need for more flexibility may require reform of Chapter 101 requirements.

In addition, an assessor's office and its professionals need to be given the resources they require. Adequate funding of a municipal assessor's office is important. Priority funding of resources should be budgeted and found for revaluations, reassessments, field inspectors, appraisers and attorneys with tax appeal experience. The assessor's office is where a municipality generates its revenues, and short selling an assessor's resources and ability to act creates a logjam at the revenue source.

Tax appeals may inevitably result in settlements and decisions with large refunds. Municipalities can share the burden of tax appeal adjustments with schools and county taxing authorities by making prospective settlements where possible. The burden of proof is on the taxpayer, and in some instances it may make more sense to bring cases to trial where there is a lack of evidence to reflect the value of a particular property. If the tax appeal is frivolous, forcing the hearing may result in withdrawals of unfounded challenges.

Assessors and chief financial officers must effectively communicate during the budgeting process. In the event refunds must be paid, tax appeal

reserves should be funded to the fullest extent possible in order to avoid the possible need for local finance bonding. If bonding is required, a municipality must be prepared to respond to the local finance board's inquiries and concerns if adequate tax appeal refund reserves were not provided for in the budget.

Even a conservative prognosticator will predict that the real estate market will improve in months and years ahead. However, taxation is based upon past valuation and municipal budgets yet to be drafted will have to address what we are witnessing today in the marketplace. The foresighted policy maker should take heed of current events and plan for days of want of revenue that may come in the future.

Join us in Atlantic City on the morning of Thursday, November 19 at the Annual Meeting for a lively discussion of these and other issues in "Tax Appeals in a Real Estate Recession - Strategies for Defending the Tax Base Without Wiping Out Your Budget." The author will be joined in an engaging panel discussion of these and other issues with other professionals from the fields of tax appeal defense, reassessing, municipal reserve budgeting and tax refund bonding. •