

## Real Estate Title Insurance & Construction Law

### Contamination Provides Opportunity for Property Tax Relief

A silver lining around the cloud of environmental cleanup

By Carl A. Rizzo

In many cases, developers learn through environmental due-diligence efforts that potential investment property is contaminated and will undoubtedly require some measure of cleanup if acquired. In addition to ensuring they have retained the proper team of environmental professionals to assist in navigating the many minefields presented by the opportunity, developers should also determine if the contamination warrants a reduction in real property taxes.

#### Contamination Negatively Impacts Value

While New Jersey is known as

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the Garden State, it is also regrettably home to many contaminated properties as a result of its long history of industrial development. With over 20,000 contaminated sites, New Jersey has the most Superfund sites in the nation. ("Superfund" is the name given to the environmental program established to address abandoned hazardous waste sites, as well as the fund established by the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), as amended, 42 U.S.C. Secs. 9601-9675.)

In many instances, but typically when property is being sold, owners and parties to the contemplated transaction are faced with addressing and allocating contamination cleanup costs. The remediation of a contaminated property involves significant costs and regulatory delays that can be financially crippling to the unwary. These costs and delays are

highly material to negotiations relating to the sale and will undoubtedly impact the market value of the property.

At the same time, however, there is a frequent disconnect between the fair-market value and the tax assessment attached to such properties. Although the New Jersey Constitution and statutes require that all properties be assessed at their fair-market value (i.e., true value), tax assessments relating to contaminated properties are often grossly overstated because they typically ignore the negative impact contamination has on the property's value. See N.J. Const. of 1947 art. VIII, sec. 1, para. 1; and N.J.S.A. 54:4-23. Consequently, parties already burdened with significant cleanup responsibilities are further handicapped by excessive real-property tax bills that adversely affect their ability to simultaneously carry and clean up these impaired properties. Nevertheless, parties may seek relief by resorting to a tax appeal.

#### Must Cease Contaminating Use

Courts have consistently recognized the need to account for the negative impact contamination has on value. See *Inmar Associates v. Borough of Carlstadt*, 112 N.J. 593 (1988). However, the need for the property owner to cease using the subject property for a use that caused the contamination in the first place, was

recognized as an essential prerequisite to allowing a party to receive a negative adjustment to value associated with contamination clean-up costs. The court expressly noted that it would not thwart environmental policies designed to promote cleanup by polluters by affording these same bad actors the opportunity to enjoy a reduction in their real-property tax obligations without first terminating the polluting use and commencing the cleanup process.

More recently, our courts echoed *Inmar's* requirement that a reduction in value due to contamination is only appropriate where a cessation of the use of the contaminated property is demonstrated. In *Pan Chemical Corp v. Hawthorne Bor.*, the Appellate Division held that the cessation of use of the contaminated property must occur before any value deductions for contamination cleanup can be applied. 404 N.J. Super. 401, 412 (App. Div. 2009); see also *Badische Corp. (BASF) v. Town of Kearny*, 288 N.J. Super. 171 (App. Div. 1996) (recognizing that no value adjustments for environmental cleanup expenses was to apply unless there was a cessation of the use causing the contamination). In particular, *Pan Chemical* confirmed that clean-up cost deductions could not be applied where, on the one hand, for tax appeal purposes, the owner claimed that an obligation to clean the property existed, but on the other hand, for compliance with New Jersey Industrial Site Remediation Act, N.J.S.A. 13:1K-6 to 14 (ISRA), clean-up obligations were not yet triggered. Such an attempt to take inconsistent positions was deemed to be fatal. The *Pan Chemical* court thus found the ISRA definition of "operations" controlled the determination on cessation of use in that instance.

#### Clean-up Costs To Be Capitalized

Even, however, where a cessation of the polluting use has been established, the *Inmar* court, nevertheless concluded that simply deducting the clean-up costs from the value of the property, as if clean, on a dollar-for-dollar basis, would be inappropriate. Although the court did not ultimately decide the proper measure of deduction warranted, or provide a particu-

lar method for making such calculations, it did suggest that these costs could be treated as a capital expense and capitalized over the term of the expected clean-up period.

Subsequently, in *Metuchen I v. Borough of Metuchen*, 21 N.J. Tax 283 (Tax Ct. 2004), the Tax Court followed the direction of *Inmar* and calculated the reduced value of the property due to contamination by subtracting from the unimpaired value of the property: (a) the present value of the five-year anticipated clean-up costs (discounted by 9 percent); and (b) an incentive fee based on 10 percent of the total property acquisition costs to compensate the developer for his entrepreneurial efforts.

#### General Stigma Damage

Importantly, the court also recognized that a further "stigma reduction" associated with a contaminated property might be required where adequate proofs of such a contamination stigma (e.g., increased health risks, higher insurance premiums, increased lending fees and property-monitoring expenses) are shown to exist. Where empirical sales data shows that the contamination has caused further devaluation, a greater discount, over and above the capitalized value of the cleanup, may be indicated. The *Metuchen I* court, however, found the proofs supporting a "stigma" adjustment were lacking and therefore refused to apply any further adjustment in that instance.

The Tax Court, in an unpublished opinion entitled *Ciba Specialty Chemicals Corp. v. Township of Dover*, Docket Nos. 005635-2004; 001986-2005; and 001501-2006, 2013 WL 6438501 (N.J. Tax Dec. 5, 2013), utilized the guidance provided by both *Metuchen I* and *Inmar*, and clarified that a contaminated property site must be viewed as a whole, with the stigma applying to any and all parcels that are components of the overall site. The *Ciba* court concluded that while a particular component parcel may be free from contaminants, it would not be free from the stigma associated with the property as whole being designated as a Superfund site.

#### Sale of Subject Property

With this historical backdrop, the Tax Court, in a recent unpublished decision, *Orient Way Realty v. Township of Lyndhurst*, Docket Nos 003895-2006; 00434-2007, and 003219-2008, --- N.J.Tax ---, 2013 WL 6576262 (N.J. Tax July 22, 2013), concluded that where there is a cessation of operations at the property, contamination must be considered in fixing value. In fact, the *Orient Way* court recognized that clean-up costs are to be considered even where no formal clean-up plan has been approved by the New Jersey Department of Environmental Protection pursuant to ISRA. These costs are then properly capitalized to arrive at the appropriate measure of the contamination deduction to be applied to reduce the unimpaired "clean" value of the property, and thereby allowing for a determination of the property's true value.

Because the purchaser of the property in *Orient Way* was taking the property subject to the cost of the environmental investigation and cleanup, the court assigned great weight to the sales price in fixing value. Indeed, the *Orient Way* court recognized that when sophisticated parties negotiate a sales price, operating with full knowledge of the expected scope of the cleanup and the magnitude of the obligation, as they did there, the parties will, often by necessity, incorporate the appropriate contamination discount into the final sales price and in so doing help to resolve any question about the true value of the property as impaired.

In sum, contamination and attending clean-up obligations should be carefully evaluated to ensure that the current assessment levels attached to these properties correctly reflect true value. By pursuing this very analysis, the property owner in *Orient Way* was able to realize a reduction in annual assessment of over \$4 million. While the magnitude of tax relief will vary on a case-by-case basis, owners of contaminated properties should ensure that their adversely impacted properties are being fairly assessed for real-property tax purposes. Only by consulting with a team of real-property tax and environmental professionals can a proper evaluation be conducted to determine if tax relief is indicated. ■