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Reducing Real Property Tax Assessments in New York State Based on Contamination

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I. INTRODUCTION

In recent years, the escalation of real property taxes has been quite dramatic. Real property taxes can often actually equal or exceed debt service costs for a property (especially in light of recent interest reductions) and will frequently represent the largest expense on a property's operating statements. Property taxes represent real cash flow and high real property taxes will often limit an owner's ability to mortgage, lease or develop the property.

The situation may be even worse for the owner of an environmentally contaminated property. A high tax burden may be the proverbial straw that breaks the camel's back when a property is rendered unsellable or unleaseable because of contamination. Even a property which has a value in use will often have high legal, engineering and monitoring costs. The good news is that New York State allows reductions in property tax assessments for contaminated properties. Any residual doubt about whether it is a sound public policy to "reward the polluter" with lower taxes has been resolved by recognition of the concept, constitutional and statutory, that the property tax is an *ad valorem* tax, i.e. based on value, and that contamination reduces value.

New York State has specific procedures for the appeal of real property tax assessments. Any person involved in the development, management or ownership of real property should have some familiarity with the process by which an appeal can be taken to reduce or refund their real property taxes. It is doubly important that an owner of contaminated property know about its rights in this regard.

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IN THIS ISSUE

NEW YORK NEWSNOTES

DEC Settles Suit Against Rochester Utility for Excessive Smoke Emissions

DEC and State Attorney General have settled a lawsuit against Rochester Gas and Electric Corporation that requires the utility to pay a $400,000 penalty and donate 277 acres of land for a public park. DEC and the Attorney General filed the suit in February 1998 charging the utility with emitting excessive smoke from its Russell and Beebee Station power plants in violation of the state opacity standard. The suit is part of a DEC enforcement initiative to address opacity violations at nine utilities in the state. According to Attorney General Dennis Vacco, the agreement is the largest air quality settlement ever achieved by his office. As part of the settlement, the utility will fund a land preservation, parks, and natural resource project in Monroe County valued at $700,000. The project is being funded under DEC's Environmental Benefits Project policy, which allows defendants to fund community environmental projects in partial mitigation of penalties. As part of its environmental benefit project, the utility will donate 277 acres of land in the Town of Chili to the Genesee Land Trust. The utility will also fund creation of two pocket parks, Genesee Valley Greenway trail improvements, and a river otter restoration program. State Supreme Court Justice Evelyn Frazee approved the settlement. *DEC Press Release* (Mar. 16, 1998).

UPCOMING EVENTS

July 15-16, 1998

"NPDES Storm Water Permit Compliance," New York City. Sponsored by the American Society of Civil Engineers. Information: (800) 548-2723.

October 23-25, 1998

"New York State Environmental Law Section Annual Meeting Program: Fall Meeting," Hancock, Mass. Sponsored by the New York State Bar Association. Information: Lis Bataille (518) 463-3200.

WORTH READING

Chad Bowman, "Capital Ideas: Projects Abound for Improving the State's Roads, Bridges, Water Lines and Sewer Systems," *Empire State Report*, Apr. 1998, at 49.

Suzette Brooks, "Tax Aspects of Environmental Cleanup," 3/31/98 *New York Law Journal*, at 1:1.

Jim Gordon, "Across the Great Divide: In the Adirondacks, Bridging the Conservation-Development Gap," *Empire State Report*, Apr. 1998, at 38.

Stephen L. Kass and Jean M. McCarroll, "Reforming SEQRA: A Counter-Proposal," 3/31/98 *New York Law Journal*, at 3:1.

Reducing Real Property Tax Assessments in New York State Based on Contamination

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No one article can provide all the necessary details—both procedural and substantive—required to successfully preserve the rights of the taxpayer and to successfully conclude an appeal. The purpose of this article is (a) to discuss the substantive issues of valuing contaminated property, and (b) to give the taxpayer and its counsel an overview of the process so that they may preserve their rights and assure that their tax burden is maintained at a fair and equitable level.

II. THE SUBSTANTIVE LAW OF VALUING CONTAMINATED PROPERTY

Twenty or thirty years ago, virtually no one cared about a property's environmental condition. The "green" movement was still in its infancy and not yet in the mainstream of every day business. No more. The environmental movement has since landed right in the lap of every real estate person. No commercial transaction of any size could possibly close today without extensive environmental due diligence.

Owners of contaminated properties have sought to reduce their property tax assessments because contamination has reduced values. Constitutional and statutory provisions support these property owners. Article 16, § 2 of the New York State Constitution simply provides:

> "Assessments shall in no case exceed full value."

The only statutory provision relating to value is section 305(2) of the Real Property Tax Law, which provides:

> All real property in each assessing unit shall be assessed at a uniform percentage of value (fractional assessment) . . ."

After an uncertain start based on some ambiguous case decisions by the highly regarded New Jersey court system, New York State courts came to the rather firm—but obvious—conclusion that contamination reduces a property's value and that assessments must be based on this lesser value. In general, the value of the property as uncontaminated must be reduced by the remaining cost to cure. The primary unresolved issue in this area is how to value certain contaminated property which is in current use by an owner-grantor or currently being leased at normal or almost normal rentals.

The leading New Jersey cases were *Inmar Associates, Inc. v. Borough of Carlstadt*[1] and *GAF Corporation v. Borough of South Bound Brook*.[2] The owners of both properties were under orders of the New Jersey Department of Environmental Protection to clean up hot tar contaminants (*GAF*) and chemical wastes

and solvent contaminants (*Inmar*) polluting the land. The lower court determined that reducing assessments would, in effect, subsidize the cost of clean up and thus violate public policy.[3]

Upon appeal from the Superior Court, the New Jersey Supreme Court refused to adopt the public policy finding of the lower court and held that the properties must be assessed at true value. However, the Court held that such value was not to be determined by deducting the cost to cure because value and cost to cure were not synonymous. Instead, the Court suggested that the parties and appraisers find "creative" methods of determining "market" value by considering the depreciated cost of correcting the contamination over time as a deduction from an income stream, which could then be capitalized into an indicator of value. It also urged that consideration be given to value in use, as opposed to value in the resale market. This has proved to be a very elusive legal and appraisal standard.[4]

The first significant New York State case was *Matter of Northville Industries v. Board of Assessors of Town of Riverhead*,[5] which held that the value of a bulk oil storage facility in non-compliance with the Suffolk County Sanitary Code could be determined by deducting the entire cost of bringing the property into compliance.

The second major case involved one of the largest tax refunds in New York State history—over $40,000,000. *Bass v. Tax Commission of the City of New York*,[6] involved One New York Plaza, a 50 story 2,251,789 square foot office building permeated with friable or flaking asbestos. The lower court rejected the City's appraisal, holding that:

> "Respondent's real estate witness created a web of expense distinctions that are distractions. Whether the expense of asbestos abatement and physical rehabilitation is expensed or amortized is not the issue. The fact remains that respondent's legal and appraisal position that asbestos abatement and correction of the physical mechanical problems are not to be considered as effecting the value of this property is totally unsupportable."[7]

Citing *Northville*, the Court held that "since tax value has been equated with market value," a reasonable buyer would require some abatement due to the cost of correcting the building's asbestos problems.[8] The Court also undertook a lengthy discussion of the appropriate "market" rental. A lower market rent applied since tenants could rent a multitude of available uncontaminated properties. Unlike many groundwater contamination cases, the occupancy of the subject property was affected by the asbestos contamination. The Court did not adopt a clear cut method of determining value of contaminated property. The significance of *Bass* is its holding that the clean up cost of contaminated property and its effect on rental value must be accounted for in determining market value.

Allied Corp. v. Assessor, Town of Camillus,[9] involved the assessment of a disused property:

> "[O]f more than 1000 acres of earthen-walled wastebeds and buffer zones where waste material from an industrial process has been deposited to eventually solidify."[10]

The lower courts had determined that due to the abandonment of the wastebeds, the buffers had a recreational use and the wastebeds had no foreseeable use for twenty to twenty-five years. Comparable sales of swamp land were thus utilized to value the property. In reversing, the Court of Appeals stated:

> "No finding of contamination of Allied's wastebeds has been made, but many of the same economic considerations are present, most notably the "stigma" attached to environmentally damaged land in the eyes of any potential buyers, the risk that undetected or currently unclassified hazardous materials will be identified, and the costs of clean-up and rehabilitation. The particularized conditions of such properties make valuation difficult. In most instances, the comparable sales method is inappropriate, as it is in this case. We conclude that on the record the property should have been valued as a specialty."[11]

The key factual determination supporting the finding of a "specialty," i.e., a property which could not be used for any other purpose which must be valued by the cost or "reproduction cost new, less depreciation," was that the use of the wastebeds was not to accept industrial waste, but to retain it.[12] Thus, the property continued to be used.

The recitation of the environmental factors to be considered, including stigma, by the *Allied* court is interesting because presumably these factors should be considered as part of depreciation, i.e., economic obsolescence. Indeed, the Court of Appeals, more than most courts, accepts the fact that stigma affects even a rehabilitated property.

In the non-assessment case of *Criscuola v. Power Authority*,[13] the claimants sought damages as a result of their properties' proximity to a high voltage power line easement acquired by the State Power Authority. The claim for consequential damages was based upon the assertion that:

> " '[C]ancerphobia' and the public's perception of a health risk from exposure to electromagnetic emissions from power lines negatively impact upon the market value of their property and 'will render the remainder valueless.' "[14]

The Court disagreed with the scientific basis of "cancerphobia," but recognized it as a factor in fixing value without utilizing the word stigma. The Court held that the claimants' property may suffer consequential damages because:

> ". . . while a personal or quirky fear or perception is not proof enough, *the public's or the market's relatively more prevalent perception should suffice*, scientific certitude or reasonableness notwithstanding." (Emphasis supplied).[15]

The "stigma" considered in this condemnation case is analogous to one not relating to a market condition present on the property, but instead to the impact of owning property in

proximity to a property which has an environmental condition, real or perceived.

The last and most significant Court of Appeals case, *Commerce Holding Corp. v. Assessor, Town of Babylon*,[16] also held that stigma was a factor in determining value. *Commerce Holding* concerned an industrial building purchased in 1984 whose former tenant performed metal plating operations resulting in metallic contamination of ground water. The significance of this case is indicated by the fact that the cities of New York, Buffalo and Syracuse, the New York State Conference of Mayors, and the Association of Towns of the State of New York, and the County of Nassau, filed amicus curiae briefs.

Commerce Holding put the issue of contamination as a factor in proving value to rest by rejecting the Town's argument that reducing assessment value because of contamination "would succeed in shifting the cost of environmental cleanup to the innocent tax paying public in contravention of the public policy of imposing remediation costs on polluting property owners and their successor in title."[17] Part of the reason for the Court's rejection of this alleged public policy was its recognition that "CERCLA is a strict liability statute that imposes liability on property owners such as Commerce without regard to fault (*See*, 42 U.S.C. § 9607 [a] [responsible party *and* owner are liable]." (Emphasis supplied).[18]

The Court held:

> ". . . *Because environmental contamination can depress a parcel's true value, we hold that it must be considered in assessing real property tax . . .*"
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> * * *
>
> "Whatever the merits of the Town's argument, the "*full value" requirement is a constitutional mandate that cannot be swept aside in favor of the asserted environmental policy*. As the State Board of Equalization and Assessment has recognized, the public policy "argument, while possessing superficial appeal, runs afoul of the requirement found in * * * New York's Constitution, that real property may not be assessed at more than its full (fair market) value" (9 Opns Counsel SBEA No. 58 at 113 [citing N.Y. Const., art. XVI, § 2])." (Emphasis supplied).[19]

The Court also rejected arguments that the owner's entry into a consent order wherein it agreed to pay the clean up costs even if it sells the property caused the property's value to be unaffected by the contamination, because:

> "This contention is belied by the reality that a purchaser of the site, on notice of the environmental contamination, nevertheless would be liable for the cleanup costs under CERCLA (*See*, 42 U.S.C. § 9607[a]). Moreover, that Commerce has agreed to remediate the property does not resolve the question of whether, and to what extent, the contamination in fact affects the value of the land (*See*, *Firestone Tire & Rubber Co.*, 223 Cal.App.3d, at 392, 272 Cal. Rptr., at 750-751, *supra*). As Commerce's expert opined, a buyer of the property would have demanded an abatement in the purchase price to account for the contamination notwithstanding the existence of the consent order (*See*, *Matter of Northville Indus. Corp. v. Board of Assessors*, 143 AD2d 135, 138, 531 NYS2d 592). Whether a property owner's agreement to pay the cleanup costs would affect the property's value in a given case is a factual matter for the assessment board (cf., *Fjetland v. Brown*, 1990 WL 311252, at 5 (Wash Bd Tax Appl), but it cannot be said, as a matter of law, that the existence of the consent order in this case precluded an assessment reduction."[20]

The Court next moved on to a consideration of the methodology to value the property, and rejected the Town's argument that it was legal error to deduct total remaining cleanup costs from the value of the property as if uncontaminated. Recognizing that "each environmental impairment is as unique as a fingerprint" and further

> ". . . [R]ecognizing the unsuitability of the strict application of traditional valuation techniques to contaminated properties, the prevailing trend in this field has been one of experimentation and adaptation, marked by the use of traditional techniques adjusted for environmental contamination [citations omitted]. [W]e endorse this flexible approach."[21]

The Court further held that:

> "While it is not possible to prescribe any one method to assess the effects of environmental contamination, there are certain factors that should be considered. These include the property's status as a Superfund site, the extent of the contamination, the estimated cleanup costs, the present use of the property, the ability to obtain financing and indemnification in connection with the purchase of the property, potential liability to third parties, *and the stigma remaining after cleanup* [citations omitted]. . ." (Emphasis supplied).[22]

With somewhat less than an enthusiastic adoption of the petitioner's method of deducting the cost to cure from the uncontaminated value, the Court of Appeals, citing *Northville* and *Bass*, held:

> "Against this backdrop, we cannot say that the methodology here employed was erroneous as a matter of law. The valuation of Commerce's property was accomplished by the use of the income capitalization approach to determine the value in an uncontaminated state of this income-producing property, combined with a downward environmental adjustment in the amount of outstanding cleanup costs. While cognizant of the potential of this valuation method to overstate the effects of environmental contamination, we nevertheless conclude that cleanup costs are an acceptable, if imperfect, surrogate to quantify environmental damage and provide a sound measure of the reduced amount a buyer would be willing to pay for the contaminated property [citation omitted] . . ."[23]

Some of the court's lack of enthusiasm for giving a blanket approval to deduction of the cost to cure as a valuation method was because the Court stated that:

> "New valuation techniques are being developed that hold promise for the valuation of contaminated properties (*see, e.g.*, Chalmers and Roehr, Issues in the Valuation of contaminated Property, Appraisal J, Jan. 1993, at 36-38 [discussing regression analysis and contingent valuation methodology])."[24]

This hope may be overblown. The authors have participated in seminars on the valuation of contaminated properties with appraisers who tried to value cleaned up properties and to account for stigma. They all felt that there were too few sales of contaminated properties to successfully account for stigma. Perhaps as time goes by and there are more such sales, new methods may develop. However, it should be noted that New York State courts are notoriously conservative in adopting new valuation methods.

The final aspect of *Commerce Holding* to be discussed is the application of the deduction of cost to cure for properties which have a value in use. The Court of Appeals in footnote 5 to its opinion held:

> "The use of this method would be disfavored, for example, when the property is capable of productive use, but the high cleanup costs yield a negative property value. *In such a case, the cleanup costs could be more appropriately accounted for by adjustments to the projected income stream* (*See*, e.g. Mundy, The Impact of Hazardous and Toxic Material on Property Value: Revisited, Appraisal J, Oct. 1992, at 463)." (Emphasis supplied)[25]

The authors can attest to the clear reluctance of the judiciary to find a zero value for property which is successfully being owner-occupied or leased—and the absolute refusal of municipalities to settle cases on such basis—even though costs to cure must eventually be paid. Clearly, some alternative method of valuation is needed in this instance—even a "creative" method as requested by the New Jersey Supreme Court in *Inmar.*[26]

This summary of New York case law concludes with one of the most fascinating cases involving contamination and assessments. In *State of New York and Town of Moreau v. General Electric Co.*,[27] the State complained that General Electric (GE) caused a public nuisance by allowing toxic waste at a site in the Town of Moreau to contaminate the groundwater, and sought abatement of the nuisance and damages. The Town intervened, with several of its own causes of action, including a demand for damages for the alleged reduction in tax revenue resulting from reduced property tax assessments due to lower property values caused by GE's contamination. The Appellate Division dismissed all of the Town's claims except that for reduced tax payments from reduced property tax assessments due to lower property values.

For the commentators who wonder why a polluter would be liable for lower taxes on other properties, but could get a reduction in taxes on its own property, the answer is simple. The State Constitution provides that a property's assessment "shall in no case exceed full value."[28]

In summary, after the Court of Appeals holding in *Commerce Holding*,[29] there is no question that the New York courts are highly receptive to adjustment of the real property tax assessment to reflect environmental conditions. The question that then confronts the taxpayer is "how do I enforce or assert my right to a lower assessment?"

New York State has a specific statutory system for the review of real property tax assessments. In the next section the authors will describe the review procedure so that the taxpayer whose property is affected by the environmental condition can be guided in obtaining relief.

III. THE PROCEDURAL PROCESS

A. Generally

The procedural process in the State of New York is strict and is governed by the Real Property Tax Law (RPTL), except in New York City where complementary provisions of the City Administrative Code effectively controls. The RPTL and the New York City Administrative Code provide for a limited—and totally unforgivable—filing period in each and every year in which to file an administrative grievance or judicial petition to review the assessment. Failure to file on time is jurisdictional and courts may not excuse late filing for any reason whatsoever. The short filing periods must be viewed as the classic "drop dead" time periods. If you fail to file—no matter how egregious your assessments—your assessments will remain unchanged for that tax year. Adding to the difficulty is the fact that many assessing jurisdictions in the State have different administrative filing periods. Typically (except for New York City), these annual filing periods are only three to four weeks. Although the filings may appear to be pro forma, they must be made.

The appeal process in each year is a two step process. First, an administrative appeal is filed before the appropriate administrative board. As explained in more detail below, in jurisdictions outside New York City an administrative appeal is filed before the Board of Assessment Review. In New York City, the administrative appeal is before the Tax Commission.

Should the Board of Assessment Review or the Tax Commission fail to grant satisfactory relief as they generally do, the RPTL requires that a judicial petition be filed within thirty days after the publication of the final assessment roll.

B. Outside the City of New York

In all jurisdictions, except the City of New York, the administrative appeal is filed before a Board of Assessment Review within a very specific grievance or protest period. These protest periods vary by assessing jurisdictions. A summary of the protest calendar is as follows:

Nassau County	January 1st to 3rd Tuesday of January
Suffolk County	May 1st to 3rd Tuesday of May

Most Towns in New York State	May 1st to 4th Tuesday of May
Towns in Westchester and Erie Counties	June
Villages	February 1st to 3rd Tuesday of February (for a small number of villages filing periods are in November)
Cities	Varying, by City charter provisions

Failure to file a protest during these periods is a jurisdictional defect which precludes judicial review. There is no requirement for an assessor to notify you of your assessment unless there is a change of assessment. Even then, the Assessor's failure to so notify you is not a jurisdictional defect. The burden is on the taxpayer to check its assessment and to timely review it. The safest way to proceed is to immediately check the assessment after the tentative assessment roll is published on the first date of the protest period and to file very soon thereafter.

The physical form of the administrative appeal is fairly simple. The statutory form requires a taxpayer to state nothing in essence more than the identity of the property whose assessment is at issue, that the owner is aggrieved by the amount of the assessment and is seeking certain relief because of overvaluation or inequality in assessment. The Office of Real Property Services (formerly known as the State Board of Equalization and Assessment) publishes the required statutory form. It is classically "bare bones." It behooves a taxpayer who seriously expects a reduction from a Board of Assessment Review to present financial, sale and lease information with its protest. However, many if not most Boards of Assessment Review give short shift to commercial protests and save their limited resources for residential protests.

Once this administrative protest is filed, the taxpayer's rights are at least preserved.

C. The City of New York

In the City of New York, the administrative portion of the appeal process is somewhat different, and more detailed and complicated. This extra detail is generally justified because the City Tax Commission grants reductions in up to 40% of commercial property appeals before it, compared to an almost zero result in most Boards of Assessment Review. The City's protest period is January 1st to March 1st for commercial properties and January 1st to March 15th for 1-2-3 family homes. The City's administrative protest form is far more complicated and requires much more information than do protest forms outside of the City. Moreover, depending on the size of the assessment or type of property, income and expense statements may be required to be certified by an accountant or must be for a fiscal or calendar year which ended only three months earlier. Lack of such a statement results in a denial of a hearing before its Tax Commission, but not the loss of the right to appeal to the Supreme Court. A hearing will also be denied if an owner of a commercial property failed to file a real property income and expense (RPIE) statement by the preceding September 1st, as required by a City Local Law.

The more complicated City protest format often requires the guidance of both a lawyer and an accountant working together in order to file an effective appeal.

IV. What Happens at the Appeal Level?

Again, the course and fate of the administrative segment of the administrative appeal is different between the City of New York and every other assessing jurisdiction in the State, and this effectively governs when and the manner in which the environmental condition should be raised.

As a general rule, the administrative protest filed before a Board of Assessment Review in jurisdictions outside New York City will typically be rejected and the assessment confirmed. In Nassau County, where over 40,000 appeals are filed annually, the Board of Assessment Review will not even hear cases involving prior pending years. Most, but not all, boards in the State act similarly.

The result is that assessment review is basically a judicial process with little input by the administrative boards legislatively established to assist in this task. Therefore, the taxpayer with environmentally contaminated property can expect little relief at the administrative level outside the City of New York and the documentation, even if supplied, is likely to produce little, if any, result. Legislation currently pending before the State Legislature may reform the Boards of Assessment Review into a more responsive type of system; but as the situation currently stands, the taxpayer should assume that the assessment will typically be confirmed or only nominally reduced, thereby requiring the filing of a judicial petition.

In New York City, however, the Tax Commission is generally far more responsive. It will schedule hearings for all fully prepared protests and, depending on the negotiating atmosphere existing in any one year, reduce 40% or more of the assessments it reviews. In the New York City administrative system, the environmental material is therefore likely to be far more productive of positive results.

V. The Next Step in the Appeal—The Judicial Level

Wherever in the State the appeal is taken, the administrative board (the Board of Assessment Review or Tax Commission) must confirm an assessment roll by a date certain. The publication of a final assessment roll varies depending on the assessing jurisdiction. Among others, these finalization dates are October 24th for New York City, April 1st for Nassau County, and July 1st for most towns in counties outside of New York City and Nassau County.

The typically unsatisfied taxpayer must now file a judicial petition to maintain its right to challenge its assessment. The RPTL (as well as the New York City Administrative Code) requires that a petition be filed within thirty days after the finalization of the roll in the Supreme Court of the county in which the property is located.[30] Such a petition is governed by RPTL Article 7, and is often called an "Article 7" proceeding.

Again, the judicial petition filed is generally a pro forma complaint which in many ways is reflective of the administrative grievance: merely reiterating that the taxpayer is aggrieved, identifying the property, requesting relief on various grounds (over-valuation, inequality) and requesting that the Court grant relief accordingly. Whether the appeal is from a New York City (i.e. Tax Commission), confirmation of the assessment or a Board of Assessment Review confirmation (outside of New York City), there is no need to reference the contamination in the judicial complaint as a basis for relief.

VI. FRACTIONAL ASSESSMENT

The taxpayer must now prove the merits of its case—specifically, that the property is over-assessed or is unequally assessed. Such proof consists of two elements: 1) ratio which must be proved in all assessing units which assess at less than 100% of full, and 2) value (where the contamination issue among other valuation factors would be presented), which is discussed in greater detail *below*.

A. Ratio

Perhaps nothing is as mysterious as the question of "ratio" of assessment to full value. Fractional assessment has been the subject of intense litigation throughout the State of New York for at least three decades. The Court of Appeals, in *Hellerstein v. Town of Islip*,[31] held that properties must be assessed at 100% of their full fair market value. At first blush, this may seem quite obvious, but the Court of Appeals holding ran contrary to almost two centuries of practice throughout the State in which the assessing jurisdictions (for various reasons, political or otherwise) did not annually reassess or revalue their property at full value. As a result, properties began to be assessed at fractions of their full fair market value. The State Legislature responded to this situation by establishing State equalization rates to equalize assessments for apportionment of State aid and County and School taxes.[32] Eventually, taxpayers won the right to use the State rates as proof of ratio—thereby greatly simplifying their ability to prove ratio at a certiorari trial.

In those jurisdictions where assessments were unchanged and market values were increasing at an accelerating pace, ratios dramatically dropped. Thus, some assessing jurisdictions had ratios as low as 2%, while others were at 100% or more. The Court of Appeals in *Hellerstein* essentially held that all assessing jurisdictions must annually reassess at 100% of fair market value.

This caused a tremendous amount of turbulence throughout the State since reassessing every piece of property, both commercial and residential, at 100% of full fair market value, or even equalizing commercial and residential properties at the same level, would produce a tremendous negative reaction from residential taxpayers who are traditionally favored by this fractional and chaotic assessment system.

The Legislature in an attempt to "rescue" the situation embarked on a virtually endless series of amendments to the RPTL which were essentially designed to try to preserve the system which existed before *Hellerstein*—i.e., fractional assessments, and also to prevent the inevitable shifting of the tax burden to residential properties (primarily single family homes) that would result from any equalization inside the tax rolls between commercial and residential properties.[33]

This situation eventually came to some state of rest in 1981 when the Legislature established a special "niche" for New York City and Nassau County by characterizing them as "special assessing jurisdictions," and allowed them to utilize "classified assessment rolls."[34] The law creating this article and other elements of the assessment "fix" was so contentious that it was one of only a handful of laws adopted this century over a Governor's veto.

In New York City and Nassau County, the assessment rolls are classified into four separate categories, with the following ratios of assessment to full value:

		New York City	Nassau County
Class 1	Residential	8%	3+/-%
Class 2	Residential	45%	8+/-%
Class 3	Utilities	45%	15+/-%
Class 4	All other commercial	45%	8+/-%

With some changes, these are the generally utilized negotiated and stipulated ratios. Official property class ratios are issued by the Office of Real Property Services pursuant to RPTL Article 12, which are generally lower then these stipulated ratios. Complete rules for proof of ratio at a trial are set forth in RPTL 720(3).

Additionally, the Legislature authorized every other assessing jurisdiction in the State meeting certain standards to become "approved assessing jurisdictions" eligible to establish separate tax rates for homestead and non-homestead properties.[35]

1. Establishing the Ratio /Why It's Important?

As a practical matter, the ratio is the essence of every tax appeal. The ratio (or issue of "inequality") is the means by which the market value imputed to the property by the assessor can be determined. For example, in the Town of Huntington, where the 1996 ratio is approximately 2%, a property worth $1,000,000 should be assessed at $20,000 ($1,000,000 x 2%). Similarly, in the Town of Islip, where the 1996 ratio is about 30%, a $1,000,000 property should be assessed at $300,000 ($1,000,000 x 30%). In Nassau County, where the Class 4 ratio (which applies to commercial property) is approximately 8%, a Class 4 commercial property valued at $1,000,000 should be assessed at $80,000. Of course, the tax burden in each of these jurisdictions is not as divergent as these assessments would indicate since the tax rates are different in each jurisdiction. Thus, the tax rates in the Town of Huntington are much higher than the tax rates in the Town of Islip.

Generally, a municipality will stipulate to the State equalization rate, or some other ratio either generally agreed upon by

it and the local tax certiorari bar, as is the case in Nassau County, or self-promulgated by the municipality, as is the case in New York City.

B. Valuation

In the State of New York, case law has recognized the three methods of valuation traditionally used by appraisers. These are the (i) income approach, (ii) market approach, and (iii) cost approach. Valuation as determined by appraisal text books or case law is as much art as science. Exact precision is impossible, but it is here that the environmental condition comes into play.

Simply stated, under the income approach an "economic" rental or income flow is attributed to the property as well as an "economic" expense burden and the net income is then capitalized into value. Thus, a property with a $10,000 net operating income and a 10% capitalization rate would have a value of $100,000 ($10,000÷.10). Of course, this is a gross over-simplification since there are multiple types of approaches to the income approach (overall cap rate, building residual, land residual, etc). Additionally, the selection of the capitalization rate as well as the so-called "economic" income or expense requires a thorough analysis of comparable properties.

The market approach is also commonly known as the "sales" or "whole to whole" approach. The appraiser there must analyze the sales of so-called comparable properties, typically on a unit basis, such as acre or square footage basis, and arrive at a value for the property under review.

The cost approach is also known as the "summation" or "bricks and mortar" approach. There, the appraiser—usually relying on an engineer or other building expert—will determine the reproduction cost of the property new, less physical, functional and economic depreciation.

Generally, especially for income producing properties such as office buildings and shopping centers, the courts have leaned toward the use of the income approach—even where the property is owner occupied.[36] Where the property is owner-occupied or the actual leases are either above or below market or were not negotiated on an arms length basis, the courts will determine an "economic rental" based on expert evidence and apply the appropriate capitalization rate to arrive at fair market value.[37]

The use of the income and/or the market approach has found acceptance, even for very large and unique industrial properties, such as a 2,000,000 square foot A&P distribution center.[38]

The courts have held that the use of the cost approach is not favored and will be utilized only when (i) the property is a "specialty" erected for a very special and unique use, such as the New York Stock Exchange, and cannot be feasibly valued under any other methods, or (ii) as a ceiling of value on the theory that a property can only be valued at the total of its land and building cost unless "specialties" are very rare and are almost never found except in the more unique types of properties such as the stock exchange case.[39] Use of the cost approach as a ceiling of value, although often discussed, is also rare.[40] Until recently, it would probably have been a safe statement to make that courts would rarely, if ever, find a specialty and would reject the cost approach. However, some recent decisions involving various industrials have indicated that the courts are now more inclined to the use of the cost approach.[41]

In general, a recent arms length sale of the property is generally regarded as the best proof of value,[42] although even that sales price may have to be adjusted if the property was subject to a below market or above market lease. Comparable sales must be closely analyzed and adjusted. This is a very difficult task which often results in the market approach being set aside in favor of the income approach.

VII. CONTAMINATION

As we have observed earlier in this article, the public's burgeoning concern with contamination and the innumerable environmental restrictions and requirements have had a major effect on the real property market. No investor—whether it be a developer, lending institution, lesee, etc.—will make any major investment in a piece of real property without first satisfying itself about the environmental condition of the property. The costs and liability for remediation are enormous and translate themselves directly into sale prices and marketability, leaseability and mortgageability of any piece of property.

As these environmental concerns impacted the real property market, taxpayers began to seek relief from the courts demanding that their assessments be reduced to account for the actual or potential remediation costs and effects on a property's value. Of course, assessors resisted. We have previously discussed in detail the development of valuation law as it relates to contaminated properties.[43] Simply stated (admittedly an over-simplification), the New York Court of Appeals set the general guidelines in the recently decided case of *Commerce Holding*,[44] which held that the remaining cost to cure should be deducted from the value as if uncontaminated. Other issues such as the "stigma" affecting remediated property and the taxable value of property currently producing income whose cost to cure exceeds its uncontaminated value were recognized and left open, but it is clear that the New York Courts are receptive to reduction of assessment because of the environmental condition.

VIII. STANDING

A. Generally

The New York statutory scheme has a very broad standing requirement. The controlling statute is RPTL 704(1), which allows "any person claiming to be aggrieved by any assessment of real property" to file a judicial petition to review the assessment.[45]

Under this standard, virtually any person or entity affected by the excessive assessment has standing to appeal. In addition to, owners this can include lesees, tax lieholders, trustees in bankruptcy, as well as mortgagees.

1. Lesees

The right of tenants who are not net tenants of 100% of the

premises to challenge assessments has been restricted by *Waldbaum, Inc. v. Finance Administration.*[46] The rule is that 100% net tenants may generally file as a matter of right, as may any tenant whose lease specifically assigns to it the landlord's right to protest. Left unsettled are situations involving multiple assignments of the right to protest. The public policy limiting the ability of partial tenants to protest is based on the Court's desire to avoid multiple parties. Also unsettled is the meaning of leases giving partial tenants a non-exclusive right to protest.

2. Mortgagees

The position of a mortgagee requires some special attention because, typically, the courts will not recognize standing of a mortgagee especially where the mortgage is performing and the mortgagee can show no special need of protection.[47] The authors disagree with the reasoning of the Court in *Suburban Federal Savings*. A mortgagee would always have an interest in assuring the best possible cash flow even for properties that are supposedly performing. Realistically, the standing of a mortgagee is somewhat restricted. The Court in *Suburban* held:

> "In the present case, there is no proof that the owner of the premises is in immediate danger of defaulting on his mortgage debt, or that foreclosure on the property would not offset any outstanding assessment as well as the mortgage debt. Therefore, petitioner's alleged injury is a mere possibility separated by several contingencies from the status of the petitioner in *Matter of Walter* (*supra*) (compare *Matter of Mack* v. *Assessor of Town of Ramapo*, 72 A.D.2d 604, 421 N.Y.S.2d 109)."[48]

Therefore, it would appear that a mortgagee will be deemed to have standing in any of the following circumstances:

(a) The mortgagor has defaulted and the mortgagee has paid taxes to protect its lien; or

(b) The mortgagee has taken over possession or management; or

(c) A judgment of foreclosure has been issued; or

(d) A foreclosure action has been commenced; or

(e) The mortgagor has assigned its right to file to the mortgagee.

We also suggest that mortgagors generally establish controls in the mortgages to require mortgagees to institute tax certiorari proceedings through experiences tax certiorari counsel or to report to the mortgagor why such a review is not necessary.

3. Contract Vendees

Even the most sophisticated real estate attorney is often totally unaware of the fact that a contract vendee has the right to file a tax appeal.[49] Interestingly, this may actually be one of the most important pieces of knowledge in the arsenal of the experienced real estate practitioner. Because of the extremely limited filing period, it is possible—if not likely—that a contract vendee will often find itself "inheriting" a tax bill based on an assessment where the protest period passed unnoticed between contract and closing.

The importance of this situation is exemplified as follows: Assume that your client has entered into contract in December 1997 in New York City to purchase a property for $10 million, which is assessed as if it had a fair market value of $20 million. The New York City appeal period is January 15 to March 1, 1998. The parties closed in April 1998 and the buyer receives its City 1998/99 tax bill in July 1998. The buyer is outraged by the level of taxes and immediately (and properly so) calls its attorney with instructions to appeal. However, the period in which to appeal the assessment reflected on that July 1998 bill long since passed on March 1, 1998. Had the buyer (now owner) simply filed its grievance (and then necessary judicial petition) as a contract vendee, its rights to seek a reduction and ultimately refund in that assessment would have been preserved. Now, unfortunately, that buyer must wait until the next appeal period in 1999 to begin its appeal process, unless it is lucky enough that the seller had filed the necessary protest and petition.

In addition to this obvious situation, many properties purchased are already under appeal and the contract vendee can "piggy back" on proceedings for prior tax years and thus participate in settlement negotiations or even the trial of such tax years. A buyer can even move "as the real party in interest" to join proceedings filed by the then owner for tax periods which may affect it.

IX. BANKRUPTCY

Use of the Bankruptcy Court by owners of real property to seek relief for under-performing or insolvent property is, of course, well known to the reader. However, a bankruptcy no way impairs the ability to protest an assessment. It actually greatly enhances it as a matter of law and in the psyche of the Assessor who greatly fears the Bankruptcy Court.

The Bankruptcy Code has a specific provision, section 505,[50] to deal with the determination of taxes for a bankrupt. Typically, this provision has been utilized by the debtor or various creditors to deal with income and sales tax situations. However, section 505 confers upon the Bankruptcy Court the jurisdiction to review every type of tax which affects the debtor's assets including real property taxes. The Bankruptcy Courts, despite the special localized nature of the real property tax, have indicated a definite willingness to exercise their discretion to determine the appropriate real property taxes for a property owned by a bankrupt.

Bankruptcy proceedings are particularly valuable where a bankrupt has failed to timely protest the assessment of its properties. Bankruptcy is the only vehicle available which allows a taxpayer to review assessments when a timely protest has not been filed. However, the bankruptcy courts have distinguished between situations involving paid and unpaid taxes.

The following schedule summarizes whether bankruptcy courts will review unprotested taxes:

	Taxes are Paid	*Taxes are Unpaid*
Court will Review:		

Protested Assessments	Yes	Yes
Unprotested Assessments	No	Yes

This is a very dramatic legal trend since it may provide a "court of last resort" to properties in severe distress, especially where the economic stress has been caused by egregious assessment levels.

The Bankruptcy Court in approaching the valuation question is required to apply the same valuation standards applicable in the state court and not apply special rules to protect the debtor. However, the perception is that the Bankruptcy Court would not necessarily feel itself bound by the same valuation standards applicable in a state court and that its primary concern being the bankrupt estate, could conceivably apply a valuation standard more favorable than the taxpayer/debtor would otherwise receive in the state court. This is why Assessors generally settle assessment review cases in Bankruptcy Court.

The Bankruptcy Court's approach to valuation may not be of great significance in the State of New York where the state courts have been receptive to reducing tax assessments because of contamination,[51] but may be quite significant in New Jersey.

In contrast to New York, where the New York Court of Appeals has recognized the deduction of the remaining cost to cure in arriving at an appropriate valuation, the New Jersey courts have rejected this approach.[52] Yet, it would appear that for a New Jersey property the Bankruptcy Court, in addition to rejecting the jurisdictional filing requirements of New Jersey, would be inclined to apply a valuation standard on behalf of the debtor which the debtor was not likely to realize in the New Jersey Tax Court even had it filed properly.[53]

X. CONCLUSION

The negotiating and trial preparation process is beyond the scope of this article. However, one truth can be derived.

In New York State, every person involved with real property whatever their status (owner, developer, lending institution, etc.) should always pay special attention to the real property tax assessment since the filing requirements are so time sensitive and the loss of these appeal rights—which are very easily exercised—are extremely valuable to the viability of every piece of real property.

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[1] *Inmar Associates, Inc. v. Borough of Carlstadt*, 549 A.2d 38, 112 N.J. 593 (1988).

[2] *GAF Corporation v. Borough of South Bound Brook*, 549 A.2d 38, 112 N.J. 593 (1988).

[3] *Inmar Associates, Inc. v. Borough of Carlstadt*, 518 A.2d 1110, 214 N.J.Super 256, 266 (App. Div. 1986).

[4] *See*, e.g., *Badische v. Kearney*, 672 A.2d 186, 288 N.J.Super 171 (App. Div. 1996), now on remand __ N.J.Super __ (decided March 5, 1998), which has been remanded *two* times because of the difficulty of applying the standards set forth in the *Inmar* case.

[5] *Matter of Northville Industries v. Board of Assessors of Town of Riverhead*, 143 A.D.2d 135, 531 N.Y.S.2d 592 (2d Dep't 1988).

[6] *Bass v. Tax Commission of the City of New York*, 179 A.D.2d 387, 578 N.Y.S.2d 158 (1st Dep't 1992), *leave to appeal denied*, 80 N.Y.2d 751, 587 N.Y.S.2d 287 (1992). Lower court opinion published in the *Real Property Tax Administration Reporter*, New York State Office of Real Property Services (formerly State Board of Equalization and Assessment), Vol. 1, No. 4, p. 3.

[7] *Id.* at 8.

[8] *Id.*

[9] *Allied Corp. v. Assessor, Town of Camillus*, 80 N.Y.2d 351, 604 N.E.2d 1348, 590 N.Y.S.2d 417 (1992).

[10] *Allied Corp. v. Assessor, Town of Camillus*, 80 N.Y.2d at 353.

[11] *Allied Corp. v. Assessor, Town of Camillus*, 80 N.Y.2d at 356.

[12] *Allied Corp. v. Assessor, Town of Camillus*, 80 N.Y.2d at 358.

[13] *Criscuola v. Power Authority*, 81 N.Y.2d 649, 621 N.E.2d 1195, 602 N.Y.S.2d 588 (1993).

[14] *Criscuola v. Power Authority*, 81 N.Y.2d at 651.

[15] *Criscuola v. Power Authority*, 81 N.Y.2d at 654.

[16] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d 724, 673 N.E.2d 127, 649 N.Y.S.2d 932 (1996).

[17] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 729.

[18] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 729, n.3.

[19] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 729-730.

[20] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 730-731.

[21] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 731.

[22] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d at 730-1. Note that the Court of Appeals once again made reference to "the stigma remaining after cleanup." This is a clear opening for arguing for lower assessments for properties which have been subject to a cleanup.

[23] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 NY2d at 732.

[24] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 NY2d at 732, n.4.

[25] *Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 NY2d at 732, n.5.

[26] *See above* text accompanying notes 1 to 4.

[27] *State of New York and Town of Moreau v. General Electric Co.*, 199 A.D.2d 595, 604 N.Y.S.2d 355 (3rd Dep't 1993).

[28] N.Y. Const., Art. 16, § 2

[29] *See above* text accompanying notes 15 to 24.

[30] RPTL 702(2).

[31] *Hellerstein v. Town of Islip*, 37 N.Y.2d 1, 332 N.E.2d 279, 371 N.Y.S.2d 388 (1975).

[32] *See* RPTL Article 12.

[33] A description of the various remedial legislation attempted by the legislature and the complicated litigation which followed is beyond the scope of this article. However, a history of the Legislature's efforts and the various legislation can be found in New York State Bar Journal, June 1982 (Volume 54, No. 4) "A Real Property Tax Bouillabaisse: S. 7000A, Slewett & Farber and Colt," by William D. Siegel and Donald David. *See*, also New York State Bar Journal, November and December 1987 "Proof of Inequality: A Shifting Sea of Sand," by Eugene Morris and William D. Siegel.

[34] *See* RPTL Article 18.

[35] *See* RPTL Article 19.

[36] *Merrick Holding Corp. v. Board of Assessors*, 45 N.Y.2d 538, 382 N.E.2d 1341, 410 N.Y.S.2d 565, 567 (1978); *White Plains Properties Corp. v. Tax Assessor of City of White Plains*, 50 N.Y.2d 839, 407 N.E.2d 1332, 430 N.Y.S.2d 35 (1980).

[37] *See, Ciuffini v. State*, 42 A.D.2d 1036, 348 N.Y.S.2d 268 (4th Dep't. 1973); *Amsterdam Urban Renewal Agency v. Masonic Association*, 39 A.D.2d 617, 331 N.Y.S.2d 120 (3d Dep't. 1972).

[38] *See Great Atlantic & Pacific Tea Co. v. Town of Horseheads*, 42 N.Y.2d 236, 366 N.E.2d 808, 397 N.Y.S.2d 718 (1977).

[39] *People ex rel New York Stock Exchange v. Cantor*, 221 A.D. 193, 223 N.Y.S. 64 (1st Dep't 1927), *aff'd*, 162 N.E. 514, 248 N.Y. 533 (1928).

[40] *People ex rel Hotel Paramount v. Chambers*, 83 N.E.2d 839, 298 N.Y. 372 (1949).

[41] *General Motors Corporation Central Foundry Division v. Assessor of the Town of Massena*, 146 A.D.2d 851, 536 N.Y.S.2d 256 (3d Dep't 1989), *lv. denied*, 74 N.Y.2d 604, 543 N.Y.S.2d 397 (1989); *FMC Corp. v. Unmack*, ___ A.D.2d ___, 662 N.Y.S.2d 907, 1997 N.Y. Slip Op. 7853 (4th Dep't 1997), *lv. granted*, 91 N.Y.2d 806, 691 N.E.2d 633, 668 N.Y.S.2d 561 (1998); *In the Matter of Kraft, Inc. v. Town of Canton*, No. 94-433 (Sup.Ct., St. Lawrence County, January 17, 1996).

[42] *W.T. Grant Co. v. Srogi*, 52 N.Y.2d 496, 420 N.E.2d 953, 438 N.Y.S.2d 761 (1981).

[43] *See* section I.

[44] *Commerce Holding v. Assessor, Town of Babylon*, 88 N.Y.2d 724, 673 N.E.2d 127, 649 N.Y.S.2d 932 (1996)

[45] Interestingly, the authors of this article have a 1764 City of Boston tax bill signed by Samuel Adams hanging in their office which states that "any person aggrieved may apply for ease, as the law directs."

[46] *Waldbaum, Inc. v. Finance Administration*, 74 N.Y.2d 128, 542 N.E.2d 1078, 544 N.Y.S.2d 561 (1989).

[47] *See Suburban Federal Savings v. Mayor*, 76 A.D.2d 841, 428 N.Y.S.2d 323 (2d Dep't. 1980).

[48] *Suburban Federal Savings v. Mayor*, 76 A.D.2d 841.

[49] *Mack v. Assessor of Town of Ramapo*, 72 A.D.2d 604, 421 N.Y.S.2d 109 (2d Dep't 1979).

[50] 11 U.S.C. § 505.

[51] *See Commerce Holding Corp. v. Assessor, Town of Babylon*, 88 N.Y.2d 724, 673 N.E.2d 127, 649 N.Y.S.2d 932 (1996). *See* also above text accompanying notes 15 to 24.

[52] *See above Inmar* and *GRF* cases discussed in the first installment of this article.

[53] *See Custom Distribution Services (Debtor) v. Perth Amboy*, 216 B.R. 136 (decided December 17, 1997).

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