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By Melvyn Tarnopol, Fox Rothschild

Learn Before You Lease - Something to Know About Real Estate Tax Apportionment

When entering a real estate contract, it is always wise to fully understand what it is that you are agreeing to. Many people may overlook certain aspects of the contract that seem standard; however this can result in headaches that could have been avoided. A great example of this is the case of SPJ, Inc. v W2005/Fargo Hotels (Pool C) Realty, L.P., 2010 WL 4237371 (N.J. Super. A.D.), in which a landlord and tenant litigated over the percentage of real estate taxes each party would be responsible for.


Melvyn Tarnopol

In this case, the landlord – who owned land containing a hotel and parking lot – decided to lease an unimproved portion of the property to a tenant who wanted to construct a restaurant. The ground lease stated the tenant would pay "lessee's proportionate share" of real estate taxes – which was determined by dividing the total square footage of the restaurant to be constructed by the total square footage of all the buildings on the land. This resulted in the tenant being responsible for 33% of the taxes.

While the ground lease did have an alternative procedure for the allocation of taxes – by granting the tenant an option to seek a separate assessment for the leased land – this alternative did not say how to go about assessing the leased land.

After the restaurant's completion, the tenant complained that the assessment relating to the restaurant was too high, since the cost to build the restaurant improvements was only $732,000, and the increase in the assessment, for all of the buildings, was $1,583,000. The tenant requested that the landlord appeal the tax assessment and also have the taxes separately assessed.

Four years later, the tenant notified the landlord that the tenant was seeking a separate assessment as provided in the lease. The Tax Assessor informed the tenant if a separate tax bill were needed for the leased land, the landlord would have to effect a subdivision of the leased land from the balance of the parcel, meaning there could be separate tax assessments for each.

A few months later, the tenant obtained an appraisal from a private firm that concluded the tenant's improvements were over-assessed by the tax assessor. The tenant told the landlord that the tenant's share of the real estate taxes should be reduced. The landlord refused and, within a year, the tenant brought a declaratory judgment complaint, asking the court to declare that the appraisal was controlling, so the 33% allocation would be reduced.

The Appellate Division reversed the trial court's decision to reform the lease and held that the allocation provision was clear. There were two choices. The tenant could pay 33% of the real estate taxes or could request a separate tax assessment, requiring subdivision. Since the lease did not authorize use of an appraiser, the court rejected the tenant's argument that the appraisal should be used.

If the tenant wanted the value of the restaurant's improvements to be factored into the real estate taxes, the tax allocation provision in the lease should not have been based on square footage. The tenant could have saved a good deal of time and money by ensuring that the clause provided for a subdivision application, prior to signing the document. This would have had to include a determination as to who would pay the cost of the subdivision going into the deal. Furthermore, the landlord would have had to determine whether a subdivision would be acceptable prior to agreeing to such a clause.

This case illustrates how things can go awry when entering a real estate transaction without addressing all of the details. While a subdivision of the property may not have been possible, both parties could have agreed to a clause stating that the percentage of taxes owed would be based on the value of the improvements, instead of square footage. To prevent yourself from being caught in a similar situation, make sure you read everything you sign, and read it well.

Melvyn Tarnopol is a partner at Fox Rothschild's Atlantic City, NJ office. ■