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In the Zone

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Be Aware: Proper Authentication of Documents Required in New Jersey Foreclosure Actions

By John L. Grossman

In last month's issue, we reported on an unpublished decision issued by the Superior Court of New Jersey, Chancery Division, Bergen County, which held that a foreclosing lender, under the facts of that case, was not required to possess the original note evidencing the underlying loan obligation at the time the complaint was filed. That decision, while constituting persuasive authority, is not binding on similarly situated courts throughout the State. In fact, other lower courts have held to the contrary. More recently, in a opinion approved for publication on Jan. 28, 2011, Presiding Judge Stephen Skillman, writing for the Appellate Division in *Wells Fargo Bank, N.A. v. Ford*, held that Wells Fargo, as the foreclosing lender, failed to present adequate evidence that it was entitled to prosecute the foreclosure action. This opinion constitutes binding authority.

Wells Fargo took an assignment of a note and mortgage from Ford's initial lender, but the assignment was not recorded at the time of the filing of the amended complaint. Wells Fargo moved for summary judgment, supported by a certification from an individual, ostensibly familiar with the underlying transaction documents, in which he stated that he had knowledge of the amount due, that Wells Fargo was the holder and owner of the note and mortgage, and that the documents attached to his certification were "true copies." Ford, who represented herself, challenged the motion, asserting among other things that certain documents relating to her mortgage application constituted forgeries.

In reversing the trial court's grant of summary judgment in favor of Wells Fargo, the Appellate Division focused on the question of whether Wells Fargo established that it subsequently acquired ownership or control of the note from the initial lender. In discussing the three categories of parties under the Uniform Commercial Code which have the right to enforce a negotiable instrument and, consequently, if the instrument is secured by a mortgage, have standing to maintain a foreclosure action, Judge Skillman concluded Wells Fargo failed to present adequate evidence it was a "nonholder in possession of the instrument who has the rights of the holder," the only one of the three categories of parties within which Wells Fargo could fit.

In focusing on the certification submitted in support of the motion, the Appellate Division agreed that, if properly authenticated, the documents could be found sufficient to establish Wells Fargo as a party entitled to maintain the foreclosure action. However, the court found that the certification failed to allege that the author had personal knowledge, that Wells Fargo was the holder and owner of the note and, in fact, gave no indication as to how the author obtained that alleged knowledge. The certification also failed to indicate the source of the author's alleged knowledge that the mortgage and note were "true copies." Furthermore, the purported assignment of the mortgage, which an assignee must produce to maintain a foreclosure action, was not authenticated in any manner; it was simply attached to a reply brief. In short, the trial court should not have considered the document, absent actual authentication based on personal knowledge.

The case also presents some interesting discussion regarding Wells Fargo's holder in due course defense to Ford's counterclaim. Those issues will not be discussed here. Suffice to say, in response to the investigation regarding "robo-signing" of foreclosure pleadings, the courts are taking lenders to task to assure their pleadings comply with the requirements of the Rules of Court.

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Judge Vacates Jury Verdict in *MFS*, Inc. Case

By M. Joel Bolstein

On Feb. 16, 2011, Judge Joel Slomsky of the U.S. District Court for the Eastern District of Pennsylvania issued a 142-page decision vacating the jury verdict that held four Pennsylvania Department of Environmental Protection (PADEP) employees in the Northeast Regional Office personally liable for $6.5 million in a claim filed by MFS, Inc. under Section 1983 of the Civil Rights Act and Pennsylvania common law. I wrote about that jury verdict and its implications in a blog posting on March 8, 2010.

The same judge who heard the case originally has now granted the post-trial motion filed on behalf of the PADEP employees for a Judgment as a Matter of Law, which vacates the jury verdict. I can hear the collective sigh of relief all the way from Harrisburg, Wilkes-Barre and the other regional PADEP offices.

In the decision, the judge goes over the testimony in meticulous detail. On MFS's First Amendment retaliation claim, the judge ruled the exercise of the company's First Amendment rights was not a substantial or motivating factor for the actions of the PADEP employees, which included issuing a draft Title V permit with conditions the plaintiff found objectionable. In that regard, Judge Slomsky wrote:

> When regulators such as Defendants propose lawful terms in a Draft Permit, or draft an internal memorandum for their supervisor, or in the case of an attorney for his or her client, this conduct is not evidence of antagonism. If such conduct of a regulator could amount to antagonism under the law, it would inhibit a public employee from performing his or her duties in the best interest of the public.

The judge went on to note the PADEP employees were acting in a "charged atmosphere" where they were simultaneously trying to "assuage the feelings of angry residents living close to the plant" and enforce "environmental statutes and regulations without forcing a viable business in Pennsylvania to shut down." In those circumstances, the judge found that issuing NOVs and putting conditions in a draft permit "were appropriate." The judge went on to say PADEP and its employees "have extensive discretion in enforcing state environmental laws." That discretion included taking actions necessary to compel compliance with the state's regulations on malodors.

One fact the jury found highly indicative of malice on the part of the PADEP employees was the issuance of a field enforcement order on a Friday with a response required in one day. The judge didn't see it that way, noting the issuance of the field order was a final action of the Department, giving the plaintiffs a right to appeal that order to the Environmental Hearing Board (EHB), which they did. The judge also noted the company was represented by counsel before the EHB and had a meaningful opportunity to be heard with regard to the field order, but it withdrew that appeal when a settlement was reached with the Department. After reviewing all the testimony, Judge Slomsky concluded:

> The evidence admitted at trial shows that [the PADEP employees'] actions were rational and appropriate, rather than egregious and outrageous, even when viewing the evidence of claimed animus offered by MFS in the light most favorable to the company. When operating in a highly regulated industry, some animus between a regulator and the regulated will naturally arise, especially when a business makes a request which is not granted. Sometimes a lawsuit will follow, but a court should not readily convert itself into a mechanism to settle disputes between a company and regulators when the law affords the regulator latitude in decision-making.

The judge noted recent decisions involving Section 1983 claims applied a "shocks the conscience" test to avoid pulling the courts into second-guessing the decisions of state and local governments. After reviewing the evidence, Judge Slomsky concluded the actions of the PADEP employees in this case did not "shock the conscience." In fact, he found their actions reflected "decisions that needed to be made by regulatory officials who are responsible for regulating a company that has the potential to cause great harm to the environment and public if certain procedures or standards were not followed." Those regulators are given "broad discretion," and Judge Slomsky found the PADEP employees were "acting within the scope of the discretion afforded to them under statutes and regulations."

Lastly, on the issue of whether the actions of the PADEP employees were covered by governmental immunity, the judge ruled "each Defendant is protected by the cloak of qualified immunity." That conclusion was based on the fact that MFS had failed to present evidence upon which a reasonable jury could find liability on the constitutional claims and also on the fact

Correction

In the article "PA Construction Workplace Misclassification Act Signed Into Law" in our November 2010 issue, we incorrectly noted the intentional misclassification of an employee is considered a third-degree felony. The intentional misclassification of an employee is in fact a third-degree misdemeanor. We apologize for the error.

that "a reasonably objective regulator would not know that his conduct was unlawful."

In the key passage of the decision, Judge Slomsky summed up the case as follows:

> [I]t is evident that MFS sued [the PADEP employees] because it resented the malodor citations and other decisions that Defendants and their PADEP colleagues made in the course of carrying out their responsibility to protect the environment and the public. Although a regulated entity has constitutional and common law rights, it would be unjust based on the evidence presented at trial to hold [the PADEP employees] liable in their individual capacity for lawfully performing their statutory and regulatory duties. Consequently, a miscarriage of justice would result if the verdicts against Defendants DiLazaro, Bedrin, Wejkszner, and Robbins were allowed to stand.

I think there are important lessons to be drawn from this case. First, there will always be disagreements between the Department and the entities it regulates. When disagreements arise, all parties must act like professionals. When things get heated, parties need to step back and cool off, on both sides. The MFS jury verdict provided a useful reminder that a PADEP employee is first and foremost a public servant and must act accordingly. Presumably, the overturning of the jury verdict does not erase the lesson learned. Second, I hope the overturning of the jury verdict will dissuade those whose first reaction to an adverse action on the part of the Department would be to bring a discrimination claim against the Department. I saw the MFS jury verdict as the nuclear bomb of dispute resolution. The Slomsky decision has now taken that out of the arsenal. My feeling is there are many, many more effective ways to resolve a dispute with the Department.

Presumably, MFS will have a right to appeal the judge's decision overturning the jury verdict to the Third Circuit, so we may not have heard the end of this case.

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Court Weakens Government Contractor Immunity

By Clair E. Wischusen

In September 2010, the U.S. Court of Appeals for the Fifth Circuit denied a government contractor immunity protection from damage claims by residents impacted by Hurricane Katrina. The court held the specifications approved by the government were not precise enough to qualify for the defense. The ruling from *In re Katrina Canal Breaches Litigation*, 2010 WL 3554302 (Fifth Cir. Sept. 14, 2010), diverged from previous immunity cases and may result in increased exposure to third-party liability claims.

The U.S. Army Corps of Engineers contracted with Washington Group International, Inc. (WGI) for engineering and construction services on a large project in New Orleans. The plaintiffs sued WGI, claiming its negligent and improper actions in fulfilling the contract were a cause of flood damage resulting from Hurricane Katrina. The district court initially granted summary judgment for WGI based on government contractor immunity.

Government contractor immunity, first articulated by the U.S. Supreme Court in *Boyle v. United Technologies Corp.*, 487 U.S. 500 (1987), evaluates government contractor immunity from negligence claims by third parties with a three-prong test. Namely, liability for defects cannot be imposed when (1) the United States approved reasonably precise standards; (2) fulfillment of the contract conformed to those specification; and (3) the supplier warned the United States about known dangers.

In applying *Boyle*, the appeals court held the services performed by the contractor were not done so pursuant to reasonably precise government specifications, and as such, failed the first prong of the legal test. Therefore, the defendant was not entitled to protection under the government contractor defense.

In previous immunity cases, the court has focused primarily on the extent of the government's involvement in reviewing the contractor's specifications. However, *In re Katrina* seems to impose a heightened standard on what constitutes reasonably precise standards. The court chose not to focus on the government's development of the standards but rather on the contactor's review and execution of those standards.

In light of *In re Katrina*, government contractors would benefit from engaging in a detailed discussion of specification requirements and should be aware of the liability risk associated with the use of design-build contracts.

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City of Philadelphia Zoning and Land Use Approvals

The City of Philadelphia is now offering a Developer Services Program for new real estate projects requiring zoning and land use approvals in the city. If we can be of assistance to you in connection with any such projects, please contact Robert W. Gundlach, Jr. at 215.918.3636 or rgundlach@foxrothschild.com or Carrie B. Nase at 215.299.2030 or cnase@foxrothschild.com.

PA Commonwealth Court Holds Church Satisfies Parking Requirement Condition and Reinforces Importance of Written Decisions and Proper Procedures

By Ronald P. Kalyan, Jr.

In the case of *Maple Street A.M.E. Zion Church v. City of Williamsport*, 7 A.3d 319 (Pa. Commw. Ct. 2010), Maple Street A.M.E. Zion Church entered into a sales agreement for a property in the City of Williamsport that did not have enough space on site for parking spaces. (A building covered almost all of the property.) The property was located in an R-2 area and had been used as a laundromat before the City of Williamsport enacted an ordinance requiring at least 15 off-street parking spaces. As the laundromat was not a permitted use under R-2, it became a nonconforming use and exempt from the parking requirements. A church was permissible in the R-2 zone as a conditional use and was required to have at least one parking spot for every 10 members, calculated by the number of persons permitted in the church by the building code. The building code limited occupancy to no more than 75 people, which would have required eight parking spaces. The church had a membership of only 25 people at the time of the application.

The church applied for a variance and zoning interpretation concerning the parking spaces. The Zoning Hearing Board (ZHB) concluded at the hearing that a variance was not needed because the church required less parking than did the former laundromat and the church should proceed before City Council to have its parking issues considered. The ZHB, however, did not issue a written decision, and the church subsequently published a public notice in the local newspaper stating there had been a deemed approval from the ZHB. The church failed to post the property with the requisite deemed approval notice. No one appealed the deemed approval.

Prior to the zoning hearing, the church had also applied for a conditional use permit from the city. Following a hearing that occurred about two months after the zoning hearing, the City Council granted the conditional use, but with several stipulations. One required the church to obtain a written license for eight off-street parking spaces, which the church secured with its neighbors who had space available on their property for about 30 parking spaces.

The church entered into the license agreement with its neighbors about two months after the conditional use hearing. However, before doing so, the church appealed City Council's determination to the trial court on the basis the parking condition should not have been imposed because the parking portion of the nonconforming use enjoyed by the laundromat continued to apply to the property and because a deemed approval had occurred. The trial court remanded the matter to City Council to determine if the parking requirement imposed upon the church was subject to the law of nonconforming use and, if so, whether City Council had the power to place parking constrictions under its conditional use power to override any pre-existing nonconforming use.

On remand, City Council determined the nonconforming use was terminated when the laundromat was sold to the church and therefore no longer applied. The church again appealed to the trial court on the same bases as its prior appeal. The trial court then determined the nonconforming use had ended but the church had obtained a variance by deemed approval because the ZHB failed to issue a written decision. Both the church and the city appealed.

The Commonwealth Court determined the trial court did not have jurisdiction to review the deemed approval issue, emphasizing the proper pursuit of a deemed approval is by a mandamus action and not a collateral attack through an action before a body different from the body that failed to issue the deemed approval. Further, the Commonwealth Court held that even if the church had properly filed a mandamus action seeking deemed approval, it still would not have prevailed. The church erred in carrying out the procedures for a deemed approval when it failed to post the property with the notice of deemed approval. The deemed approval was not properly perfected. Under the Pennsylvania Municipalities Planning Code (MPC), the church was required to give public notice, in the manner so provided, within a reasonable time from the ZHB's failure to render its decision. The Commonwealth Court emphasized that posting of the property is required under the MPC, and the church failed to post the property. The deemed approval was determined to be void *ab initio*.

The Commonwealth Court also determined City Council did not have the authority to decide whether the nonconforming use enjoyed by the laundromat ended when the property was sold to the church, even though the trial court had remanded the matter back to it on that issue. Because City Council did not have such authority, its decision on that point was invalid, but the Commonwealth Court highlighted that City Council properly stipulated its conditional use approval on the provision of the eight additional parking spaces. On the question of whether the church had satisfied the condition of obtaining the eight parking spaces, the Commonwealth Court said yes, noting the church satisfied that condition when it entered into an agreement with the neighboring property owners who had 30 parking spaces available. Accordingly, the Commonwealth Court affirmed the trial court that the conditional use permit and the use and occupancy use permit should be issued, but on different grounds.

The *Maple Street Church* case highlights the importance of a municipal board

memorializing its decisions in writing. It also emphasizes that an applicant seeking a deemed approval must follow all MPC procedural requirements in order to obtain it—including, without limitation, physically posting the subject property and pursuing a mandamus action to secure approval, if necessary. The applicant in the *Maple Street Church* case was fortunate to have cooperative neighbors. Otherwise, it may have been hamstrung in its efforts to develop the property after squandering the opportunity to obtain a valuable deemed approval allowing it to develop without parking restrictions.

The real estate attorneys at Fox Rothschild have extensive experience in navigating the permit approval process and in obtaining deemed approvals in appropriate cases.

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Study Claims Open Space Generates Economic Benefits

By Robert W. Gundlach, Jr.

Conservation and planning leaders have released a new study claiming preserved open space throughout southeastern Pennsylvania generates hundreds of millions of dollars in economic benefits.

Commissioned by the GreenSpace Alliance and the Delaware Valley Regional Planning Commission, the study quantifies the value of open space in Bucks, Chester, Delaware, Montgomery and Philadelphia counties. The study—the first of its kind for southeastern Pennsylvania—examines the economic benefits associated with preserved open space in four key areas: property values; the environment; recreation and health; and jobs and revenue.

Approximately 14 percent of the land, or 300 square miles, in the five-county region is preserved open space. According to the study, this open space provides substantial economic benefits. Specifically, this space:

- Increases homeowners' property values by an average of $10,000 per household;
- Saves local governments and utilities more than $132 million a year in costs associated with environmental services such as drinking water filtration and flood control;
- Helps residents and businesses avoid nearly $800 million in direct and indirect medical costs and saves businesses an additional $500 million in workers' compensation costs and costs related to lost productivity;
- Generates more than $566 million in annual spending, $299 million in annual salaries and $30 million in state and local tax revenue; and
- Supports nearly 7,000 jobs.

By 2035, the population of southeastern Pennsylvania is expected to grow by 393,000 people. Continuing at the current rate of land consumption, 167,000 acres of open space—an area more than half the size of Montgomery County—would be subject to development over this period.

The study, prepared by the Economy League of Greater Philadelphia, Econsult Corporation and Keystone Conservation Trust, aims to provide elected leaders, policy makers and the general public a new perspective on the value of open space and help them make informed decisions about future development.

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Residential Sprinkler Mandate Under Renewed Scrutiny in PA

By Kimberly A. Freimuth

The Pennsylvania Builders Association reports that Pennsylvania State Representative Everett's newly introduced House Bill 377 would help new home purchasers by eliminating the residential sprinkler mandate from the statewide building code.

Effective Jan. 1, 2011, all new one- and two-family dwellings are required to contain fire sprinklers under Pennsylvania law.

HB 377 intends to remove that sprinkler mandate from the Uniform Construction Code. It would not impact the similar requirement for town homes. The legislation would be retroactive and protect from the mandate those new home purchasers who already have contracts and building permits.

The bill requires that prior to entering into a purchase contract, the home builder offers the consumer the option to install an automatic sprinkler system as well as provide them with information about sprinkler systems. Additionally, it includes building code provisions that enhance safety for firefighters by creating new fire floor protection standards in the event the consumer does not choose sprinklers as an option.

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DE Chancery Court Decision Clarifies Title Owner of Church Real Estate

By Michael J. Isaacs

In *The Peninsula-Delaware Conference of the United Methodist Church, plaintiff, v. Robert Short, et al.* (Del.Ch. Jan. 12, 2011) Laster, V.C., the Chancery Court was asked to decide whether church property belonged to the trustees of the church on behalf of the local congregation or the United Methodist Church (UMC).

From 1914 to 2010, the congregation of the Bethany United Methodist Church (the Bethany congregation) worshipped at the church property in Millsboro, Delaware. Until 2010, the Bethany congregation was affiliated with the Peninsula-Delaware Conference of the UMC (the Pen-Del Conference). In 2009, a dispute arose between the Bethany congregation and the UMC. The Pen-Del Conference filed its action in Chancery Court to obtain a declaration that the UMC holds title to the building traditionally used by the congregation, the plot of land where the church is located and the chattels associated with the operation of that church (collectively, the "church property"). The Bethany congregation disputed this claim and argued its members, and not the UMC, held title to the church property.

The original deed to the real estate was recorded in 1914 and transferred title to the "trustees of Bethany Methodist Episcopal Church at Lowes Crossroads." The Bethany Methodist Episcopal Church was incorporated as a religious corporation under the laws of the State of Delaware. In 2007, additional contiguous property was transferred to the trustees. When the congregation was formed, it affiliated with the Methodist Episcopal Church. From 1939 through 1968, the Methodist Church merged several times to finally form the UMC. The Bethany congregation was part of the Dover District, which was part of the Pen-Del Conference, a division of the UMC. As a member of this conference, the congregation agreed to abide by the UMC's governing documents.

The sole issue before the Chancery Court was a determination of the ownership of the church property. The decision required an examination of the two deeds that transferred the real estate, the charter of the congregation and the governing documents of the UMC.

The court noted each of the deeds granted the land in question to the "trustees of Bethany Methodist Episcopal Church," and as such, title does not vest in the individuals who serve as trustees, but rather such title is held in trust for the benefit of the Bethany congregation as a member congregation of the UMC. The UMC's governing documents also provide that local church property is held in trust for the parent denomination. Accordingly, the court found the church property is held in trust for the benefit of the UMC, which is entitled to all possessory rights.

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Senators Seek To REIN in Federal Regulations

By Lauren W. Taylor

In an effort to decrease thousands of pages of federal regulations, 25 U.S. senators are co-sponsoring a bill designed to curb the growth of federal administrative law.

The Regulations from the Executive in Need of Scrutiny (REINS) Act of 2011, introduced by Senator Rand Paul (R-Ky), would require Congress to approve every new major rule proposed by the executive branch before it can be implemented and enforced.

Under the REINS Act, major rules drafted by an administrative agency would require approval by both bodies of Congress and the signature of the president. A major rule is any rule the Office of Management and Budget finds may result in an annual impact of $100 million or more; a major increase in costs for consumers; or significant adverse effects on the economy.

The legislation would reverse the century-old trend of Congress delegating its regulatory authority through various forms of enabling legislation to agencies with technical expertise.

Proponents claim the administration has a history of using back-door regulations to enact policies it cannot pass through legislation. The legislation seeks to deny unelected bureaucrats unchecked power to make policy without the affirmative consent of Congress.

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NJ Real Estate Tax Appeals: Valuation of Apartment Complexes To Obtain Proper Assessment for Real Estate Taxes

By Jeffrey M. Herskowitz

As an owner of an income producing property, such as an apartment complex, your tax assessment of the property is critical in maintaining a profitable business. Once an owner receives its year assessment notice (within the first two weeks of February) for real estate, the owner has a statutory time period, usually until the first Monday in April, to file an appeal of the assessment. The appeal may be heard before either the Tax Court or the County Board of Taxation, depending on the value of the assessment. The taxpayer will then have the opportunity to present expert testimony as to the assessment of the property. If the appeal is filed with the County Board and the parties are not satisfied with the county's decision, either may file a complaint with the Taxation Division of the Superior Court. The critical component of the process towards a proper assessment is the method of valuation of the real estate.

There are three approaches to valuing real estate to obtain a proper assessment: (1) cost approach; (2) market approach; and (3) income approach. The cost approach is measured by how much it would cost to replace the property should it need to be rebuilt at the time of assessment. The market approach compares a property to other similar properties in the area. In the income approach, you determine the income of the property in order to compute the proper assessment. This article will focus upon the income approach, as it is the most practical way to value an apartment complex.

The objective in assessing real estate is to ascertain the fair-market value of the property, which will then be converted into a proper assessment. The property assessment made by a local authority is presumed correct.[1] The taxpayer has the burden of proof to overcome the presumption by showing sufficient competent evidence to show the true valuation of the property.[2]

A prospective purchaser would expect a fair return upon his or her investment in an apartment complex and would therefore review the income history to determine the potential income.[3] The income approach is initially based on an analysis of rental income.[4] First, the gross income is estimated, with a reduction for vacancy and loss allowance to compute an effective gross income. After expenses are deducted, this net operating income is then capitalized at a rate to arrive at a true value.[5]

A critical part of the income analysis is determining the economic rent, which is known as the "market rent" or the "fair rental value."[6]

A landmark case that discusses the proper way to calculate "economic rent" is *Parkview Village Assoc. v. Collingswood*, 62 N.J. 21, 297 A.2d 842 (1972), where the court stated:

> It is of course settled that gross rental income for purposes of applying the capitalized income approach to valuation of property is to be taken at "fair rental value," professionally termed "economic" rent or income, if that differs from current actual rental. However, actual income is a significant probative factor in the inquiry as to economic income. Checking actual income to determine whether it reflects economic income is a process of sound appraisal judgment applied to rentals currently being charged for comparable facilities in the competitive area. The essential, however, is a plurality of comparables.[7]

Therefore, in a community without rent controls, one must compare rents payable at similar properties in the area for the relevant period.[8] Where there are rent controls, according to ordinance or where the complex is partly subsidized by the government, those factors need to be taken into account. For example, if an ordinance permitted a complex owner to charge a maximum amount of rent and the maximum was higher than the actual rent, that maximum rent would be the "economic rent" rather than the actual rent.[9]

The general rule is that absent convincing evidence to the contrary, the actual rent of a well-managed apartment complex functioning with customary leases of relatively short length (i.e., one year), is prima facie representative of the economic rent for purposes of the capitalized income valuation.[10]

A municipality can overcome the presumption that a well-managed complex is equivalent to economic rent by proving

1 *Rodwood Gardens, Inc. v. City of Summit*, 188 N.J. 34, 455 A.2d 1136 (1982).
2 *Id*.
3 See *Middlesex Builders, Inc. v. Township of Old Bridge*, 1 N.J. Tax 305, 314 (1980).
4 *Parkway Village Apartments Co v. Township of Cranford*, 108 N.J. 266 (1987); see also *Helmsley v. Borough of Fort Lee*, 78 N.J. 200, 214-15, (1978) (income method preferable for income-producing property).
5 See Appraisal Institute, *The Appraisal of Real Estate*, 429-450 (10 ed. 1992).
6 *Parkway* at 270.
7 69 N.J. at 29-30, 297 A.2d 842 (citations omitted).
8 *Rodwood Gardens, Inc.* at 34.
9 See *Borough of Little Ferry v. Vecchiotti*, 7 N.J. Tax 389 (1985).
10 *Parkway Village Apartments Co. v. Township of Cranford*, 108 N.J. 266, 528 A.2d 922 (N.J. 1987).

convincing evidence that the leases are not economic because (1) the property is not well-managed; (2) they are old, long-term leases, or (3) a comparison with at least four similar apartment properties reveals they are not economic.[11]

Where a municipality attempts to overcome that presumption, a court will need to determine the status of the complex on a case-by-case basis. For example, where the municipality challenges a complex's decreased gross revenue due to mismanagement, a complex owner may defend its revenue position by showing how the complex has design problems that would affect its utilities provided to the tenants, functional obsolescence and increased competition in the area.[12] The municipality, in turn, could argue, for example, that the complex could provide a more efficient means of providing a heating system, which would in turn increase its revenue.

The vacancy rate of an apartment complex is a factor to be deducted from gross revenue. The vacancy rate is not determined as of the date of the assessment, but must be determined according to the long-term quality and durability of the property's income stream.[13]

The expenses of the complex also must be deducted from the gross revenue. The actual expenses should be considered where there is no dispute as to those expenses and as long as they are not an excessive percentage of effective gross income.[14] Stabilized expenses, or a computation of an averaging of the expenses, are also an accepted practice.[15] Note that under the income approach of valuation, the inclusion of real estate taxes as an operating expense is not permitted, as the amount of those taxes are eventually determined as a result of the determination of value, and then, the appropriate assessment.[16]

The cost of management of an apartment complex is a proper expense for an income-producing property, regardless of whether an actual management fee is paid.[17] The management fee involves time for accounting, rent collection, advertising and supervision of the operation of the property.[18] The management fee, however, cannot be duplicative of a wage expense to an employee performing management functions.[19]

Reserve expenses are the expenses for the replacement of items in the apartments. Generally, the courts presume two percent of the gross income is proper for reserve expenses.[20] However, depending upon the circumstances of each case, a court may permit an increased reserve of three percent. For example, the court in *Maple Court Associates Limited v. Township of Ridgefield Park*, 7 N.J. Tax 135 (1984), found a three-percent reserve for replacements was adequately demonstrated by the taxpayer's witness and is a legitimate consideration. The sum of the overall expenses formed approximately 30 percent of the effective gross income, which the court found was appropriate.

In *Borough of Little Ferry v. Vechhiotti*, 7 N.J. Tax 389, the court stated:

> Concerning a reserve for replacement of the short-lived items such as refrigerators, dishwashers, oven-ranges, air-conditioners and carpeting, all of which were supplied by the tenants by taxpayer, taxpayer's expert based the amount for replacement on his estimate of cost and useful life. Although this estimate of remaining life was conservative when compared to that testified to by the taxpayer, whose experience in owning and operating apartments was substantial, his cost estimates were without foundations and were thus unreliable. Conversely, given the superior nature of this complex and the above average appliances and amenities furnished to the tenants, I find that borough's two percent allowance for replacement is insufficient. I find an annual reserve of three percent of the effective income is fair and reasonable.[21]

The "capitalization rate" factor for obtaining market value of a taxpayer's real property by means of the income capitalization approach combines cost of borrowed funds, which is a mortgage constant consisting of interest and amortization, and the rate of return a prospective investor expects to earn on his or her invested funds.[22] The combination of these two rates, in the proportion of invested capital to borrowed funds, produces the capitalization rate, and multiplied by the net operating income, produces the proper assessment.[23]

This exercise should produce a proper assessment. Certainly, experts for the municipality and the taxpayer will produce different results, and ultimately, the parties could attempt to resolve the matter or have the court be the final arbiter to determine the proper assessment.

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11 *Parkview*, 108 N.J. at 272, 528 A.2d 922 (citations omitted).
12 See e.g., *The Equitable Life Assurance Society of the United States v. Town of Secaucus*, 16 N.J. Tax 463 (N.J. Super. 1996) (discussing in hotel setting, how hotel's difficulties of revenue were not caused by mismanagement but by design problems, functional obsolescence and increased competition).
13 *Berenson v. City of East Orange*, 6 N.J. Tax 12 (1983); *aff'd*, 6 N.J. Tax 493 (N.J. Super. A.D. 1984).
14 See *Maple Court Associates Limited v. Township of Ridgefield Park*, 7 N.J. Tax 135, 153 (1984).
15 *Id*.
16 *Spiegel v. Town of Harrison*, 18 N.J. Tax 416, 427 (1999), *aff'd* 19 N.J. Tax 291 (N.J. Super. A.D. 2001).
17 *Borough of Little Ferry v. Vecchiotti*, at 414.
18 *Id*.
19 *Id*.
20 See *Inganamort Bros. v. Borough of Fort Lee,* 7 N.J. Tax 564 (1973).
21 *Id*. at 415; see also *Vornado, Inc. v. Borough of Totowa*, 8 N.J. Tax 214 (1986) (finding three percent reduction for reserves was appropriate); *Brunetti v. City of Clifton*, 7 N.J. Tax 161 (1984) (finding two percent reduction of reserves was appropriate); but see *Inganamort Bros v. Borough of Fort Lee*, 7 N.J. Tax 564 (1973) (holding taxpayer's expert's opinion of three percent reduction for reserves was not supported by factual evidence, and therefore standard two percent reduction of expenses was appropriate).
22 *Spiegel* at 426.
23 *Id*.

Private Transfer Fee Prohibition Proposed

By Carrie B. Nase

Pennsylvania State Senator Wayne Fontana (D-Allegheny) has introduced legislation, Senate Bill 353, that would prohibit private transfer fee obligations in Pennsylvania and provide for notice and disclosure of existing private transfer fee obligations.

Private Transfer Fees are also known as resale fees or capital recovery fees and allow the developer or builder of a home or commercial property to collect a percentage of the sales price—typically one percent—from the seller every time the property changes ownership for the succeeding 99 years. It has been utilized as a tool by some builders to create a re-occurring source of revenue off their product.

Opponents of Private Transfer Fees claim they take equity from consumers, depress home prices, create a disincentive to sell or purchase property, reduce transparency for buyers, create lien issues for lenders and increase the risk of title claims.

This legislation was also introduced in the last legislative session and was unanimously passed by the Senate. However, it was not considered by the House before the end of the session.

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Legislative Update in Pennsylvania

By David H. Comer

Senate Bill 404 proposes to amend the Pennsylvania Municipalities Planning Code (MPC) in several ways.

First, it proposes to add Section 507.1 to the MPC, which would require language of a subdivision and land development ordinance, where doubt exists as to the intended meaning of the language, be interpreted in favor of the property owner and against any implied extension or application of the provisions of the ordinance. Currently, Section 603.1 of the MPC provides that where doubt exists as to the intended meaning of the language of zoning ordinances, the language is to be interpreted in favor of the property owner and against any implied extension of the restriction.

Senate Bill 404 also proposes to give the governing body the power to consider requested relief in the nature of a variance, related and subordinate to the use for which conditional use approval is sought. Currently, zoning hearing boards hear all variance requests.

Furthermore, Senate Bill 404 proposes to add language whereby a zoning officer's preliminary opinion would be considered a determination. Additionally, the proposal would require a zoning officer to issue a written preliminary opinion no later than 45 days after receipt of a written request for preliminary opinion.

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Harsher Penalties for CWA Violations Proposed

By M. Joel Bolstein

On Feb. 15, 2011, Senator Patrick Leahy (D-Vt.) renewed his efforts to enact legislation to enhance penalties for corporations and individuals responsible for environmental crimes. Leahy first introduced the Environmental Crimes Enforcement Act in June 2010, following the April explosion on the Deepwater Horizon oil rig in the Gulf of Mexico. The Leahy authored bill will racket up penalties, including jail time, for companies that violate the Clean Water Act and provide victims of environmental crime with access to compensation for their loss. An important goal of the Environmental Crimes Enforcement Act is to ensure penalties for corporate misconduct include prison time, not fines alone, which can be a mere cost of doing business. The Judiciary Committee approved the legislation last year, but it was not acted on by the full Senate.

The Environmental Crimes Enforcement Act directs the Sentencing Commission to review and amend sentencing guidelines to reflect the seriousness of environmental

crime. It also makes restitution mandatory for Clean Water Act violations. Under current law, restitution is discretionary and only available under limited circumstances. The Environmental Crimes Enforcement Act will help victims like those affected by the 2010 oil spill in the Gulf of Mexico, including the families of those killed by the explosion on the Deepwater Horizon, seek compensation for their losses caused by criminal activity.

The Environmental Crimes Enforcement Act is co-sponsored by Senators Dianne Feinstein (D-Calif.), Sheldon Whitehouse (D-RI), Bernie Sanders (I-Vt.), Jack Reed (D-RI) and Bob Menendez (D-NJ).

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