

Real Estate Title Insurance & Construction Law

Environmental Impacts in Real Estate Valuation Litigation

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Environmental contamination often has a significant impact upon the value of real property. Buyers and sellers devote substantial effort towards negotiating a price for the sale of contaminated property which accounts for its need to be remediated under the supervision of the New Jersey Department of Environmental Protection. The price ultimately agreed upon will usually reflect the negative impact caused by the existence of environmental contamination.

There are several ways in which environmental conditions may affect the valuation of real property in litigation. In the real property tax appeal context, New Jersey courts have wrestled with the issue of the impact of environmental contamination upon real property tax assessments for more than 20 years. A recent Appellate Division decision examined those situations in which

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environmental contamination may or may not be considered by a court in arriving at the appropriate valuation of real property for taxation purposes.

Pan Chemical Corp. vs. Hawthorne Borough, 404 N.J. Super. 401 (App. Div. 2009), involved industrial property located in Hawthorne which contained seven different buildings which the property owner had occupied for 55 years, and which were used in the manufacture of industrial coatings, inks and nail polish.

In October 1999, Pan Chemical moved its manufacturing operations and 30 plus employees to a new facility in Middlesex County, leaving only three employees in Hawthorne and two of its seven buildings remaining in use. Pan Chemical did not completely shut down the Hawthorne property in order to avoid or postpone a costly environmental remediation which it would have been required to perform under the Industrial Site Remediation Act (ISRA). No efforts were thereafter made to improve or maintain the property and the owner sold the property in 2005 in an “as is” condition, with the purchaser assuming responsibility for all environmental clean-up costs.

The Tax Court found that the build-

ings on the site were in substantial disrepair, and concluded that the property should be treated as a closed, nonoperating facility. As a result, the court held that consideration of environmental clean-up costs, which had been presented by Pan Chemical during the trial, was appropriate.

The Appellate Division disagreed with the Tax Court and reversed. It relied upon the seminal case of *Inmar Associates, Inc. v. Carlstadt*, 112 N.J. 593 (1988). In *Inmar*, the New Jersey Supreme Court considered appeals regarding two different industrial properties — an asphalt plant and a solvent recovery operation. The asphalt plant, owned by GAF Corporation, had become industrially obsolete, but remained in use during the years under appeal. If it did not remain in use, then the Environmental Clean-up Responsibility Act (“ECRA”) (the operative environmental statute at that time) would have required GAF to clean up the property prior to its sale. The second property was owned by Inmar, was no longer in use, had been abandoned by Inmar’s tenant, and had been placed on the Federal Superfund list. While no clean-up had taken place as of the assessment date, NJDEP had filed suit against Inmar and its tenant to require a clean-up of the site.

The *Inmar* court struggled with how the existence of contamination and its remediation costs should be considered in valuing the property for tax assessment purposes. While recogniz-

ing that the cost of clean-up would have a depreciating effect upon a property's true value, the court specifically found that deducting these costs dollar for dollar from the true value of the property was not an acceptable methodology. The court left it to the appraisal community to arrive at an appropriate methodology.

The *Inmar* court also made note of an important distinction of great importance to the Appellate Division in the *Pan Chemical* decision. The *Inmar* court noted that the GAF property was still being utilized by the owner/occupants of the property and thus the property had a distinct "value in use" to the owner, so long as the owner continued to operate the facility. The court thus found that when property is in use, the clean-up requirement may not be triggered and the cost of clean-up may not be a factor in determining the property's true value for tax assessment purposes.

The Appellate Division in *Pan Chemical* seized upon this "value in use" distinction to find that the contamination on the subject property, and the environmental clean-up costs associated therewith, should not reduce the true value of the subject property for tax assessment purposes. Pan Chemical kept a bare minimum of employees working on the premises and continued operations in order to avoid "closed operations" status, thereby triggering the clean-up mandates of ISRA. The Appellate Division specifically stated that Pan Chemical wanted to "have it both ways." It wanted the property to be deemed "in use" during the years on appeal for the sole purpose of avoiding the costly clean-up mandated by ISRA, but now wanted the property to be deemed "not in use" over the same period of time in order to claim a reduced tax liability. *Inmar* held that an occupied property, with some level of ongoing operations at the time of valuation, will not merit a reduction in assessed property value. If the Pan Chemical property was not to be treated as "closed" for statutory clean-up purposes, then it should not be treated as a closed property for tax assessment purposes. Otherwise, there could be a "windfall tax benefit to the very persons responsible for toxic conditions, even though no actual clean-up

costs are incurred."

The Appellate Division held that the "10% of operations" definition set forth in ISRA to determine whether a property is "closed down" for statutory clean-up purposes establishes a "bright line" standard for future cases. When a property is still considered to be "in use" as defined under ISRA in N.J.S.A. 13:1K-8(1), then environmental contamination and the cost of clean-up may not be considered when arriving at the value of property for tax assessment purposes.

This decision thus establishes a new and important standard in how environmental contamination is to be treated for tax assessment purposes. While contamination may have an impact on a property's value, it may not always be considered in establishing the value of property for tax assessment purposes.

Not all property valuations are impacted by environmental conditions in the manner utilized by New Jersey courts with respect to real property tax assessments. In eminent domain valuations, condemned properties are to be valued as if any environmental conditions were remediated, so the trier of fact does not consider environmental remediation costs which may be incurred to clean up the property taken.

Environmental considerations in eminent domain valuations were the focus of the Supreme Court in *Housing Authority of the City of New Brunswick v. Suydam Investors, LLC*, 177 N.J. 2 (2003) and *New Jersey Transit v. Cat in the Hat*, 177 N.J. 29 (2003). These decisions affirm that property owners may be liable for environmental remediation costs, but established a procedure whereby the assessment of environmental remediation liability is separated from the determination of just compensation for the condemned property. *Cat in the Hat* specifically permits condemnors to reserve — in the condemnation case — any claims for present or future costs of remediation against condemnees without being subject to the defenses of res judicata, collateral estoppel, and the entire controversy doctrine. In order to protect a condemnor which acquires a contaminated property, the condemnor is permitted to establish and retain in the Superior Court Trust Fund an "environ-

mental trust escrow" from the proceeds of condemnation, which escrow may then remain available until the succeeding cost recovery action is concluded or the environmental liability is otherwise resolved. Once remediation costs are determined, that amount is disbursed to the condemnor from the escrow and the balance, if any, is paid to the condemnee.

Environmental issues are not, however, completely removed from eminent domain cases. In particular, the *Suydam* court provides a check against frivolous or exaggerated estimates of clean-up costs by providing the condemnee with a mini-trial-type hearing, as to the reasonableness of the escrow. The hearing is to proceed as a summary action under Rule 4:67, with the condemnor bearing the burden of proving the estimated remediation costs. A second way in which environmental issues can appear in eminent domain valuations is if the property taken would experience some diminution in value due to the "stigma" of being an environmentally remediated property, as opposed to a totally "clean" property.

There are other ways in which environmental considerations may infect eminent domain cases. No published New Jersey case has yet examined whether a condemnee's liability for environmental conditions should be limited to the amount necessary to clean the property to the use underlying the property's valuation as if remediated, or if the condemnor can recover actual remediation costs for the specific use the condemnor employs even if the highest and best use of the property would have probably required less extensive, and less expensive, clean-up. The constitutional requirement of just compensation would suggest that a condemnee should receive the same quantum of compensation from a forced taking as would have resulted from a private sale, but this issue awaits guidance from our courts. The proper measure of compensation and environmental liability will likely be fact-specific, and counsel in these complex matters are well advised to utilize experienced real estate appraisal and environmental consultants in order to assist in obtaining the best results for their clients. ■