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THE TAX COURT COMMITTEE ON OPINIONS
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**EAGLE ROCK CONVALESCENT
CENTER,**

Plaintiff,

v.

TOWNSHIP OF WEST CALDWELL,

Defendant.

TAX COURT OF NEW JERSEY

DOCKET NO.: 006780-2008; 008154-2009;
002089-2010; 010834-2011;
000264-2012; 000868-2013;
005687-2014

Approved for Publication
In the New Jersey
Tax Court Reports

DECIDED: January 6, 2021

Daniel J. Pollak for plaintiff (Brach Eichler L.L.C.).

Levi Kool* for defendant (O'Donnell McCord, P.C.).

NUGENT, J.T.C.

This is the court's opinion after trial of the 2008 through 2014 tax appeals filed by plaintiff ("Taxpayer") to lower the local property tax assessments on property designated as Block 1200, Lot 2 on the West Caldwell tax map, otherwise known as 165 Fairfield Avenue ("Subject Property").

The Subject Property is owned and operated as a skilled nursing facility known as Eagle Rock Convalescent Center.¹ Occupancy by private pay, Medicare, and Medicaid patients comprises the payer mix at the facility. The premise of Taxpayer's claim that the property is over-assessed relies on evidence that Medicaid comprises over 50% of the facility's total income, and

*Levi Kool argued the matters, but the opinion is being sent to the current municipal attorney, Joseph McGlone.

¹ The experts use the terms "skilled nursing facility" and "nursing home" interchangeably to identify the Subject Property.

testimony that the 2010 changes to the calculation method of the capital facility portion of the Medicaid reimbursement rate will result yearly in a 2% decrease to the Medicaid rate. As a result, Taxpayer concludes that the predominance of Medicaid as a component part of the Subject Property's income must be considered as a factor negatively affecting the value of the real estate.

The local property assessments for each tax year and average ratios are set forth below.

Tax Year	Total Assessment	Equalized value	Average Ratio	Common level range
2008	7,900,000	16,448,053	48.03%	40.82 – 60.03
2009	7,500,000	16,816,143	44.60%	37.91 – 55.75
2010	7,500,000	16,838,797	44.54%	37.85 – 55.67
2011	16,200,000	16,200,00	100%	
2012	16,200,000	16,979,352	95.41%	81.09 – 100
2013	14,200,000	14,890,940	95.36%	81.05 – 100
2014	14,200,000	14,284,277	99.41%	84.49 – 100

Taxpayer produced a general real estate appraiser who applied the Rushmore method (a type of income approach applied generally to hotels) and derived an economic rent from his opinion that the Subject Property's actual income and expenses represent the market. Taxpayer's appraiser also performed a cost approach and applied depreciation. He included external obsolescence through an opinion rooted in the Subject Property's reliance on Medicaid revenue as the dominant income source. His final value conclusions were reconciled but with the most emphasis on the income approach. Taxpayer also provided testimony of a fact witness with an ownership interest in the Subject Property who serves simultaneously as the President of Tandem Management Company and the President of Eagle Rock Convalescent Center ("Owner"). The Owner is a professional engineer and licensed nursing home administrator who manages six New Jersey nursing homes, including the Subject Property. He holds an ownership interest in all of them.

Defendant ("West Caldwell") relied on the testimony of two general real estate appraisers. The Subject Property was included in a town-wide revaluation in 2011, thereby, one expert

provided an opinion of value for tax years 2011 and 2012 (West Caldwell's "revaluation expert"). West Caldwell's second appraisal expert opined on value for tax years 2008-2010, and 2013-2014 (West Caldwell's "second expert"). Both West Caldwell experts used the cost approach only, disagreeing with Taxpayer's expert's use of the income approach as a viable method to value a nursing home. Under the cost approach, the experts disagreed with Taxpayer's expert on application of economic obsolescence to the Subject Property, as well as his allowance for total depreciation. These issues formed the basis of the dispute between the parties. The parties stipulated to the qualifications of the appraisers as expert witnesses and each expert produced a written appraisal report accepted into evidence by the court without objection.²

For the reasons explained below, the court finds that the cost approach is the more credible indicator of the Subject Property's value. In this connection, it rejects the Taxpayer's expert's and West Caldwell's second expert's improvement value conclusions because their reliance upon the SwiftEstimator software in deriving their respective unit costs for the Subject Property's improvements was unsubstantiated. Since this leaves the court with no evidence to determine the value allocable to the Subject Property's improvement, it affirms the assessments for tax years 2008-2010; and 2013-2014.

² At the close of Taxpayer's case, West Caldwell moved to dismiss the complaint pursuant to R. 4:37-2(b) for failure to overcome the presumption of validity that attaches to original assessments. MSGW Real Estate Fund, LLC v. Borough of Mountain Lakes, 18 N.J. Tax 364 (Tax 1998). The court reserved on the motion. The court finds that Taxpayer produced sufficient evidence to overcome the presumption of validity attached to the assessment as to all tax years having presented credible testimony regarding both the activity at the Subject Property and in the nursing home industry, and analysis from an appraisal expert versed in the valuation of nursing homes, using recognized valuation methods. Taxpayer's expert concluded a value well below the fair market value assumed by the assessments as equalized. Assigning to the Taxpayer every positive inference, as required by the law, the court finds Taxpayer provided evidence in support of valuation sufficient to raise a debatable question regarding the validity of the assessments at issue herein.

For tax years 2011 and 2012, the court finds credible West Caldwell's revaluation expert's use of the Marshall & Swift cost calculator and manual calculations. Based on the evidence of land value of all three experts, and of the improvement value by West Caldwell's revaluation expert, the court finds the Subject Property's value for tax years 2011 and 2012 as \$18,500,000 (rounded) and \$18,600,000 (rounded). Since tax year 2011 was a revaluation year, and West Caldwell did not file a counterclaim, the court must affirm the assessment. Further, since the court's value conclusion for tax year 2012 falls within the common level range, the court must affirm the assessment for this tax year also.

I. The Subject Property

The Subject Property is comprised of 6.01 acres of land improved with the Subject two-story nursing home. West Caldwell's experts testified that the facility measures 80,033 square feet, contrary to the measure of 83,308 square feet utilized by Taxpayer's expert. The court finds the 80,033 square foot estimate, determined from the measurement personally undertaken by West Caldwell's second expert, to be more reliable than the 83,308 square feet opined by Taxpayer's expert without having measured the space. Total square footage breaks down as 36,034 square feet for the first floor, 33,433 square feet on the second floor and the [partial] basement space occupies 10,566 square feet.

The 180-bed facility was constructed in 1987. It contains 84 semi-private and 12 private rooms for a total of 96 rooms. There are 26 sub-acute or short-term care beds, and the remainder of the beds are dedicated to long-term care patients. Constructed in a "+" configuration the patient rooms are supported by a central core of nursing stations. Lobby space, administrative offices, kitchen, dining area, lounges, a large physical therapy room, a day care room, patient units, and other incidental spaces, are distributed among the first and second floors of the facility. Two

private elevators located in the front of the building and a service elevator toward the rear of the building service the facility.

The building is constructed of steel and concrete with stucco and brick over concrete block and frame. Two-thirds of the building is built on a slab with the only subterranean portion located on the front portion of the building. Nine roof mounted package units for common areas plus sixteen gas fired boilers and one chiller in the basement provide heat and air conditioning. The facility contains an automatic wet pipe sprinkler system, central monitored fire alarm system, smoke and heat detectors, fire extinguishers and oil-fired emergency generating system. The interior finish is acoustic ceiling tiles, fluorescent lighting, and vinyl floors. Walls are painted or covered in vinyl or wallpaper, bathrooms are ceramic tile, and office areas are carpeted. There are approximately 100 paved parking spaces, with curbing, lighting, and professional landscaping at the Subject Property. Ingress and egress to the facility is provided by Fairfield Road and the Subject Property backs up to Passaic Avenue, a major thoroughfare and county road. The Subject Property is zoned office professional, and situated within a mixed-use area consisting of industrial, warehouse, retail, office, and residential uses.

The experts agreed that the facility is in overall average condition having undergone routine maintenance and upgrades since the time of construction both to remain compliant with local construction codes and as required by the New Jersey, Department of Health and Senior Services (HSS). HSS oversees nursing homes in New Jersey and conducts yearly unscheduled property inspections. Facility upgrades and maintenance of the Subject Property since the time of original construction include replacement of the roof, lighting (more energy efficient), fire alarm system and the nurse call system, furniture, larger capacity generator, and landscaping. Patient rooms were brought into compliance with current electrical code which required installation of outlets to

run emergency power, and a nine-seat dialysis unit was added in the basement. At the time of trial, the dialysis unit was yet not operational, but it was pending imminent approval for use.

Of the Subject Property's three revenue sources (Medicaid, Medicare, and private pay), Medicare pays the highest per day rate, followed by private pay.³ The Medicaid reimbursement is the lowest of the three.⁴ Taxpayer's expert and Owner described changes to the Medicaid formula enacted in 2010. According to the expert under the new formula the Medicaid rate "is based upon facility cost, less age, less 2 percent per year." In the Owner's experience, costs have been increasing but Medicaid reimbursement has been steadily decreasing.

The Subject Property draws patients from a ten to fifteen-mile radius. Hospitals serve as feeders to nearby nursing homes where the average stay for long-term care patients is three years. The hospital nearest to the Subject is seven to eight miles. Nursing home operators, including the Subject Property, compete for private pay patients many of whom have gravitated toward other forms of continuing care communities over the years. Beginning in around 2005, competition came largely with the development of assisted living facilities. Nursing homes provide the most medically intensive care of the long-term care options because of patient acuties that require, among other things, feeding tubes, wound care, and around the clock nursing services, unlike

³ A fourth source of income at the Subject labeled "Other" was comprised of a nominal amount of income which includes miscellaneous income from such sources as the beauty parlor at the facility.

⁴ Medicaid is a federal and state-funded income-based health care program. The reimbursement rate varies by county. More than half of New Jersey's nursing home residents receive financial assistance from Medicaid. Medicare is a federal health insurance program for people 65 and older. In this instance, to qualify for Medicare an individual's physician must certify that skilled nursing care or rehabilitation services are needed daily. At the point that skilled or rehabilitative care is no longer needed every day, Medicare benefits cease. Medicare will cover a maximum of 100 days of nursing home costs. Patients are categorized by health condition and the reimbursement rate is determined on a county to county basis.

residents at assisted living facilities. Instead of opting for care at a nursing home, healthier patients tend toward assisted living arrangements or at-home care.

II. Highest and Best Use

All three experts concluded that the highest and best use of the Subject Property, as vacant, is as a nursing home. As improved, the experts agreed that the highest and best use is its continued use as a nursing home, which the court accepts.

III. Experts' Approaches to Value

A. Taxpayer's Expert's Income Approach

Taxpayer's expert maintained that the income approach is the most widely and persuasive value indicator for a nursing home and is "used universally" for valuing nursing homes. In formulating his opinion, the expert relied on his appraisal experience and in part on an Appraisal Institute treatise, The Appraisal of Nursing Facilities that discussed all three approaches to value.⁵

The expert utilized a method known as the Rushmore approach to value the Subject Property. The method is recognized in valuing hotel and casino properties. See Glenpointe Assoc. et al. v. Township of Teaneck, 31 N.J. Tax 596, 616 (Tax 2020) (the Rushmore method is generally used in hotel valuation cases wherein "income attributable to the use of the realty" is "separated" from the "total income generated by the operation of the hotel before capitalization"). Because the value of the nursing home is comprised of both tangible and intangible assets, as with a hotel, the expert finds the method to be appropriate. Moreover, he finds similarity among the property types likening the nursing home to a hotel "where the typical patron-stay is short term."

⁵ The Owner testified that prior to his purchase of a nursing home, among other things he examines the income from the same.

According to Taxpayer's expert, under the Rushmore approach the appraiser "starts with a stabilized number of actually achieved income." He therefore reviewed seven years of the Subject Property's income and expense statements, identifying trends in the year over year numbers. He opined that the Subject Property's income and expense, as stabilized, represents the market. The expert's conclusion is based on his comparison of the Subject Property's "payer mix," or yearly percentage of patient days for each payer type (Medicaid, Medicare and private pay) with the payer mix at three of the Owner's other nursing homes, and a comparison of the expense data from four continuing care facilities the expert determined were comparable to the Subject Property. The three facilities used to compare payer mix were located outside of Essex County. The data appears in an Addendum to this opinion reproduced from the written report of Taxpayer's expert. (See Addendum, Chart 1).⁶

After stabilizing the income and expenses, the expert deducted from net income a percentage for a Reserves for Replacement attributed to the real estate only. He separated the value of the non-real estate items by deducting the income attributable to the personal property, or the furniture, fixtures, and equipment (FF&E). He deducted 2% from net operating income as a return on FF&E and 2% as a return of FF&E. Using the band of investment method, the expert derived a capitalization rate that he applied to net income to arrive at the value of the Subject Property. The expert derived a value for each tax year under the income approach at \$5,640,000; \$5,785,000; \$6,015,000; \$5,920,000; \$6,200,000; \$4,780,000; and \$4,710,000.

B. Cost Approach Valuations of all three Experts

⁶ The Addendum also includes charts 2 through 8 compiled by the court illustrating the experts' opinions of value, relevant comparable land sales, calculations of replacement cost new and the court's value conclusions.

In conducting the cost approach, the three experts each selected several sales of properties they considered to be comparable to the Subject that were sold for development as continuing care communities to derive the Subject Property's land value, and all agreeing that sales of land for development of nursing homes are scant. The comparative-unit method was applied to derive the improvement's replacement cost new using the Marshall & Swift (M&S) cost service data.⁷ Soft costs, and entrepreneurial profit were added to the improvement's replacement cost new, and depreciation was deducted therefrom. The Taxpayer's expert concluded a value (reconciled) ranging from \$10,470,000 to \$11,320,000 for each tax year; West Caldwell's second expert concluded a value ranging from \$16,660,000 to \$17,740,000 (tax years 2008-2010; 2013 and 2014); and its revaluation expert concluded a value of around \$19,100,000.

i. Taxpayer's Expert

Taxpayer's expert identified five land sales and derived the land value using a per bed unit measure opining that the land sales are transacted based on a per bed value. Of this, Sale 3, 100 Plainsboro Road in Plainsboro, Middlesex County (a sale common to all three experts) represented the only comparable sold for development of a nursing home. His Sale 1, (339-361 Eagle Rock in Roseland, also a comparable used by West Caldwell's experts), was for the development of an assisted living facility in the Subject Property's county. Sales 2, 4, and 5, also sold for development of assisted living facilities, with their location in other counties (Bergen, Somerset, and Monmouth). All sales, except Sale 5 which occurred in 2004, are within the relevant time-period. Based on these sales, with one negative adjustment for the Subject Property's lower bed

⁷ M&S cost service is a national cost index with local building costs defined by zip-codes or local cost multipliers. The direct costs of construction are based on building specifications including classification by building type, quality, size, and design characteristics.

count, Taxpayer's expert opined a total land value of \$25,000 per bed or \$4,500,000 for all years under appeal.

The expert utilized the M&S SwiftEstimator on-line computer software to determine the Subject Property's improvement's replacement cost new and provided the computer-generated report at trial. He selected a class A building type and input the property's descriptive information e.g., general building description, systems and type of occupancy, and the computer software calculated the basic structure cost new. The expert opined that the Subject Property suffered from all three forms of depreciation: physical (17%); functional 30% (curable at 5% and incurable 25%); and external obsolescence (33% amended to 22%). In calculating physical depreciation, the expert utilized the economic age/life method, having selected 20 years as the improvement's effective age, for all years under appeal. When the expert input the effective age, the computer software derived a figure to represent the improvement's total economic life and calculated physical depreciation. The curable functional obsolescence (manually calculated) was as to the following: location of the two passenger elevators toward the front of the building near the reception area, as opposed to a central location on the nursing home floor; no video security; lack of built-in oxygen in the patients' rooms; and, in-room controlled heating and cooling needed to replace the present centrally controlled system. In the expert's opinion, modern facilities would include those features. The expert calculated a total of \$875,000 (approximately 5% of Replacement Cost New), as the cost to cure.

Taxpayer's expert's opinion of incurable functional obsolescence (manually calculated) was measured by the average vacancy rate at the Subject facility, for which he opined a 25% market-based allowance was appropriate because the Subject Property's improvement was too large. He conducted an analysis of four of the Owner's other New Jersey nursing homes that

revealed varying average occupancy rates between 47% to 76% to support his opinion. The Owner testified that present day he would build a nursing home with just 100 rooms, all private, smaller in size than the Subject Property's 180 rooms.

The prominence of Medicaid as a revenue source led to the expert's finding of external obsolescence, which he opined is common to all nursing homes that accept Medicaid. He characterized Medicaid as "an outside from of governmental regulated control" that adversely affects the value of the Subject Property since 51% to 57% of the gross income is regulated "in a like-kind form of rent control." As the predominate form of revenue, the nursing home receives fewer dollars per Medicaid bed than it receives for a bed occupied by a private pay or Medicare patient. Both Taxpayer's expert and the Owner testified that as the improvement ages, a 2% Medicaid rate decrease will continue each year based on the 2010 changes to the reimbursement formula. According to the expert "that pattern occurs at every nursing home so it's the market."

By the expert's initial calculation, the Subject Property suffered 33% external obsolescence which he found as the percent difference between Medicaid reimbursement per bed, per day, and the private pay, per bed, per day. On cross-examination, the expert's approach was criticized for failure to account for the fact that the Subject Property derives a benefit from accepting Medicare, which reimburses at a higher rate than private pay. When he next testified, the expert had discerned "a more improved method to calculate" the external obsolescence by assigning the private pay "rate" to all Medicaid beds at the Subject Property for each year under appeal which yielded a potential gross revenue on average 22% greater than actual revenue, lower than the expert's initial 33% calculation. As further support, the expert relied on articles by Price Waterhouse Coopers (PWC) that cautions in general terms of industry-wide concerns about increased reliance on Medicaid funding to cover resident nursing home stays, declining Medicaid reimbursement rates

due to State budgetary concerns, and uncertainty nationwide about the sufficiency of Medicaid funding sources going forward. The expert adopted the revised figure of 22% as his opinion of external obsolescence and recalculated the replacement cost new of the Subject Property’s improvements.

In so recalculating, the expert again used the computer software, and produced a second computer generated report. The second report yielded a different base cost per unit than the first. The expert was unable to explain the reason why the software generated a different base unit cost (reflecting the cost new of the basic structure), report to report, although he used the same parameters and property description. The chart below reflects the difference in the “cost new – unit base cost” on the first computer generated SwiftEstimator summary report and the “cost new – unit base cost” on the second summary report generated by the SwiftEstimator:

Basic Structure: unit cost

Tax Year	2008	2009	2010	2011	2012	2013	2014
First report (date created)	151.43 7/29/13	163.19 5/29/13	154.55 5/29/13	158.96 5/29/13	165.04 5/29/13	171.41 7/29/13	175.25 7/29/13
(date calculated) ⁸	8/15/13	7/29/13	7/29/13	7/29/13	7/29/13	9/30/14	9/30/14
Second report (date updated)	152.87 2/25/15	164.36 2/25/15	155.66 2/25/15	160.10 2/25/15	166.22 2/25/15	170.17 2/25/15	173.98 2/25/15
(date calculated)	4/20/15	4/20/15	4/20/15	4/20/15	4/20/15	4/20/15	4/20/15

The decrease in external obsolescence applied by Taxpayer’s expert (22% versus 33%) caused the overall value of the Subject Property to increase under the cost approach, with the prior value conclusions ranging from \$8,305,000 to \$8,910,000 and the revised value conclusions ranging from \$10,470,000 to \$11,340,000. However, the expert did not alter his final opinion of the Subject Property value at \$6,500,000 (tax years 2008-2012) and \$5,500,000 (tax years 2013-2014), which was a reconciliation between his income and cost approach.

⁸ The difference, if any, between “date created/updated” and “date calculated” was not explained by Taxpayer’s expert however the court finds it has no effect on this court’s opinion.

ii. West Caldwell's Experts

West Caldwell's two appraisal experts considered the Subject nursing home to be a special purpose, or unique property, for which no market exists. Both opined that the income generated by the nursing home is so intertwined with the real estate that the only viable method to ascertain the value of the realty alone is via the cost approach. Moreover, they agreed about the lack of leases for competitive nursing homes to establish market rent in this case which they opined precluded use of the income approach.

a. Tax Years 2008-2010; 2013-2014

West Caldwell's second expert used a per-acre unit measure for land after analyzing a total of five land sales with sale dates from 2005 to 2014. Unaware of the number of beds that would be approved for each property, and because he was opining on the value of raw land without approvals or a license, he concluded that acreage served as the best measure. The expert used four sales for each valuation period (2008-2010 and 2013-2014). Aside from the two common sales with Taxpayer's expert (one in Roseland and one in Plainsboro), he used land sold for development of age restricted town homes, at 66 Hanover Road, Florham Park (Morris County), sold October 2006. Another sale, 55 Locust Avenue, Roseland, sold October 2005 for age-restricted residential development, and the property at 782 Valley Road, Clifton (Passaic County) sold November 2014 for development of an assisted living facility. He made various adjustments to the comparable land sales for differences in location and development approvals. The expert opined a land value of \$2,615,000 for tax years 2008-2010, and \$2,885,000 for tax years 2013-2014.

Like Taxpayer's expert, he utilized the M&S commercial software, the SwiftEstimator, in deriving the unit costs for the improvement's value. He selected Class C building type and input the building parameters. At trial he produced the computer-generated summary report. The expert

applied total depreciation in the amount of 27% for tax years 2008 through 2010, and 32% for tax years 2013 and 2014 (attributing 5% to curable functional and the remainder as physical depreciation). He calculated depreciation manually, without use of the SwiftEstimator software. Using the economic age/life method to derive physical depreciation, he opined that the improvement had a total economic life of 45 years and selected an effective age of 10 years for 2008 through 2012, and an effective age of 12 years for 2013 and 2014. The 5% functional depreciation, curable was based on upgrades to the facility previously lacking. He then concluded the Subject Property's values as \$15,850,000; \$16,295,000; \$14,560,000; \$16,030,000; and \$16,240,000.

However, during trial, the expert corrected the type of heating system and number of elevators. He revised his replacement cost estimate, again through use of the SwiftEstimator, and input the same parameters and property description he had initially used but corrected for the heat and elevators. He then reran the computer-generated summary reports for each tax year. The same pattern emerged from comparison of the first and second reports as occurred with Taxpayer's expert: the second report showed a higher unit base cost new than on the first report.⁹ For example, for 2013 tax year, on the first computer summary report, the unit base cost was calculated as \$178.29 per unit. However, when he re-ran the numbers two years later to correct his errors, using the identical building parameters, it yielded a unit base cost new of \$179.90. That same pattern emerged for all tax years at issue. The unit base costs are reproduced from the first and second computer generated SwiftEstimator summary reports in the chart below:

⁹ The unit cost for the basic structure excludes the unit cost of exterior walls, heating and cooling, elevators, sprinklers, and miscellaneous items such as paving, etc.

Basic Structure: unit cost

Tax Year	2008	2009	2010	2013	2014
First report (date created)	163.22 2/09/13	169.69 2/09/13	163.38 2/09/13	178.29 2/09/13	183.95 2/09/13
(date calculated)	2/10/13	2/10/13	2/10/13	1/22/15	1/22/15
Second report (date created)	163.81 12/9/15	170.31 12/9/15	163.97 12/9/15	179.90 12/9/15	185.60 12/9/15
(date calculated) ¹⁰	12/9/15	12/9/15	12/9/15	12/9/15	12/9/15

Based on his corrections, his value conclusions changed to \$16,660,000; \$17,210,000; \$16,670,000; \$17,240,000; and \$17,740,000.

b. Tax Years 2011 and 2012

West Caldwell’s revaluation expert used a per unit (room) measure for valuing the land that he opined provided a uniform measure for comparison. He used the two sales common to all experts (one at Plainsboro and one at Roseland), as well as a third sale of land located at 1086 Dumont Drive, Voorhees (Camden County), which sold in September 2004 for development as an assisted living facility. The commonly used sales were consummated in 2009 and 2011, thus, proximate to the valuation dates for tax years 2011 and 2012, however, his final land sale took place in 2004, thus, much before the assessment dates for either of the two tax years. He concluded a land value of \$35,000 per unit, for a total land value of \$3,885,000. During trial, he corrected a calculation error in the number of Subject Property’s units from 111 to 96, which reduced his concluded land value to \$3,360,000.

To determine the building’s replacement cost-new he utilized the M&S Cost Estimator manual, as opposed to the SwiftEstimator computer software. The expert attached copies of the corresponding tables from the M&S manual in the addendum of his report highlighting the costs and multipliers he used to calculate replacement cost new. He divided the building into five

¹⁰ Again, the difference, if any, between “date created” and “date calculated” was not explained by West Caldwell’s second expert and has no effect on this court’s opinion.

sections to reflect the cost of the first floor, second floor, basement-finished and unfinished, and maintenance building. The expert selected Building Class B, Building Quality “Good,” for the first and second floors. For the basement area the expert selected Building Class C, Building Quality “Average.” He applied total depreciation in the amount of 24% for tax year 2011 and 26% for tax year 2012, comprised of physical depreciation, only, using the economic age/life method. He opined an average life expectancy of 50 years for both 2011 and 2012, used an effective age of 12 years for the 2011 tax year, and 13 for tax year 2012.

This expert also amended his value opinion at trial after effective cross-examination revealed that he had made several errors in his written valuation report. Aside from the room count, the expert had included the cost of the maintenance building but acknowledged it had not been built as of the valuation dates and corrected the error. He also acknowledged that he had applied the incorrect current cost multiplier and the local multiplier for both years under appeal, for sections I through IV, and testified to the correct multipliers but did not recalculate his value conclusions (\$19,276,000; \$19,128,000) using those multipliers. The court recalculated his value conclusions (with correct multipliers) and as further explained below, arrived at \$18,500,000 (rounded) and \$18,600,000 (rounded). (See Addendum, Charts 7 and 8).

ANALYSIS

I. Approaches to Value

“There are three traditional appraisal methods utilized to predict what a willing buyer would pay a willing seller on a given date, applicable to different types of properties: the comparable sales method, capitalization of income and cost.” Brown v. Borough of Glen Rock, 19 N.J. Tax 366, 376 (App. Div. 2001) (citation omitted). “There is no single determinative approach to the valuation of real property.” 125 Monitor Street, LLC v. City of Jersey City, 21

N.J. Tax 232, 237-38 (Tax 2004) (citations omitted), aff'd, 23 N.J. Tax 9 (App. Div. 2005). “The choice of the predominate approach will depend upon the facts of each case and the reaction of the experts to those facts.” Id. at 238.

The sales comparison approach requires an evaluation of market transactions that examines the recent sale of similar properties. It involves a “comparative analysis of properties” where the appraisal expert focuses on the “similarities and differences that affect value . . . which may include variations in property rights, financing terms, market conditions and physical characteristics, among others.” Appraisal Institute, The Appraisal of Real Estate, 378 (14th ed. 2013). The experts agreed that the sales comparison method was not a viable approach to value the Subject Property because nursing homes are infrequently sold, leading to a scarcity of sales data for use by appraisers. In addition, Taxpayer’s expert opined that because it would be difficult to obtain a thorough understanding of the income stream and intangibles value for any comparable property the sales approach would serve as little assistance in the appraiser’s search for the Subject Property’s value. Thereby, the experts rejected use of the sales comparison approach.

The income capitalization approach is the preferred method of estimating the value of income producing property. Parkway Village Apartments Co. v. Township of Cranford, 108 N.J. 266, 270 (1987). Through this method, “an appraiser analyzes a property’s capacity to generate future benefits and capitalizes the income into an indication of present value.” Appraisal Institute, The Appraisal of Real Estate, 445 (13th ed. 2008). Central to the income capitalization approach, and the first step in the process, is “the determination of the economic rent, also known as the ‘market rent’ or ‘fair rental value.’” Parkway Village Apartments Co., 108 N.J. at 270. The term market rent refers to “the most probable rent that a property should bring in a competitive and open market reflecting all conditions and restrictions of the lease agreement, including permitted uses,

use restrictions, expense obligations, term, concessions, renewal and purchase options, and tenant improvements.” Appraisal Institute, The Dictionary of Real Estate Appraisal, 121-22 (5th ed. 2010). The market rent attributable to a property may differ substantially from the actual rent derived on a property, which may be below market rates. Parkview Village Assocs. v. Borough of Collingswood, 62 N.J. 21, 29-30 (1972). However, “this does not mean that the actual rent is to be disregarded . . . in determining what is fair rental income, the actual rental income, while not controlling, is an element to be considered.” McCrorry Stores Corp. v. City of Asbury Park, 89 N.J. Super. 234, 243 (App. Div. 1965) (citations and internal quotation marks omitted).

“The cost approach is normally relied on to value special purpose or unique structures for which there is no market.” Marina Dist. Dev. Co., LLC v. City of Atlantic City, 27 N.J. Tax 469, 519 (Tax 2013) (citation omitted), aff’d, 28 N.J. Tax 568 (App. Div. 2015). The method values a property “based upon a comparison with the cost to build a new or substitute property. The cost estimate is adjusted for the depreciation evident in the existing property.” The Appraisal of Real Estate, 561 (14th ed. 2013). “Generally, [special purpose properties] will possess the following characteristics: they will be (1) unique and specially built for the purpose for which they are used, (2) without a market or comparable sales, (3) unlikely to be converted without substantial economic expenditure, and (4) reasonably expected to be replaced or reproduced if destroyed.” TD Bank v. City of Hackensack, 28 N.J. Tax 363, 379 (Tax 2015) (citations omitted). “The only means for valuing a special purpose property is via the cost approach because there will be insufficient comparable market transactions.” Id. at 380 (citations omitted).

II. Valuing a Nursing Home

Nursing homes are viewed as income producing properties. Rolling Hills of Hunterdon, L.P. v. Township of Clinton, 15 N.J. Tax 364 (Tax 1995) (nursing home income-producing for

purposes of N.J.S.A. 54:4-34, which statute requires that taxpayer comply with assessor's request for financial information or risk dismissal of complaint). "Patients at [skilled nursing facilities] pay for both care and lodging. Undoubtedly, the larger share of patient fees are for nursing and personal care, but it cannot be disputed that a portion of the fees are for a tenancy in real property." 962 River Ave., LLC v. Tp. of Lakewood, 30 N.J. Tax 291, 297 (Tax 2017) (citation omitted).

Use of the income approach to value a nursing home was considered and rejected in two cases which guide this court's review. One is Twin Oaks Assoc. & Health Resources of Morristown, Inc. v. Town of Morristown, 9 N.J. Tax 386 (Tax 1987), aff'd, 11 N.J. Tax 94 (App. Div. 1989), and the other is 962 River Ave., 30 N.J. Tax at 291. Twin Oaks involved a proprietary nursing home, with income derived from both private pay and Medicaid patients. The nursing home was also the subject of an operating lease among related entities, and later sold. The taxpayer's expert's income approach relied on two different methods to establish economic rent for the property. In the first, the expert derived a rental value based on a Medicaid rate established nine years prior. In the second method, the expert considered the sale of the lease to be an arms-length transaction which he utilized to derive his opinion of economic rent, allocating a portion of the rent to the nursing home's personal property (FF&E). Notably, after the lease sale was negotiated, the number of private pay patients at the facility increased.

Finding that "the income . . . approach[] [is] . . . useful where suitable information is available" the court was yet unpersuaded by the taxpayer's expert's approach.

The sale of the subject lease and the income approach based on the actual income and expenses give an indication of value but are not conclusive because the income in taxpayer's first income approach method is based on a rate fixed in 1977, and in both methods is affected by the mix of private and Medicaid patients, and the number of patients is increasing. No income valuation based on actual or projected net income was furnished.

[9 N.J. Tax at 395.]

The court concluded, “the cost approach is the only method by which to value the property uniformly with other properties in the taxing district” since the record lacked “evidence of economic rent or comparable sales of nursing homes unencumbered by governmental rate restrictions.” Id. at 395-96.

The income approach, similar in many respects to the Taxpayer’s expert’s approach here, was also rejected in 962 River Ave., LLC. In describing the income approach, the Tax Court there noted that it “generally applies to real property that generates income from the rental of the property, not from the business activities that take place at the property.” 962 River Ave., LLC v. Township of Lakewood, 30 N.J. Tax at 302. The case involved a proprietary nursing home that was not the subject of a lease, with a patient mix of Medicaid, Medicare, and private pay patients. The taxpayer’s expert used the property’s actual income derived from the patient fees, and expenses, and treated them as market. In opining value, he used the Rushmore approach to separate the income attributable to the real property from the income attributable to the business since he deemed the “operation of a nursing facility is similar to the operation of a hotel or golf course.” 30 N.J. Tax at 306. The court found the income approach unreliable since there was no “evidence of lease transactions for nursing or rehabilitation facilities,” and no “evidence of income attributable directly to the real property at such a facility.” Ibid. Nor was there evidence of the patient mix at the comparable properties which the court found would be necessary “to determine whether they were truly comparable.” Ibid.

The court found that the taxpayer’s expert’s method of allocating income among the business operations versus the real estate represented a second flaw in the income analysis. The expert formulated an adjustment of 10% to represent a management fee but derived the figure from

a review of existing management contracts for apartment buildings due to lack of the same for nursing homes given their nature of operation in a regulated industry. Id. at 307. The court rejected this adjustment “to account for the income attributable to the business operations at the subject [as] not reliable” since it lacked market support and because “it is evident there is almost no similarity between managing an apartment building and managing a nursing and rehabilitation facility.” Ibid.

III. Analyzing the Experts’ Approaches to Value

A. *Income Approach*

According to Taxpayer’s expert, he relied most heavily on the value conclusion he reached from the income approach. In his estimation he relied 66% on the income approach and 33% on the cost approach in reconciling the Subject Property’s value having found the income approach to be the most probative and appropriate indicia of value because income producing properties trade on income.

This court is unpersuaded that Taxpayer’s expert’s income approach provides a reliable indication of the Subject Property’s value for several reasons. In concluding that the Subject Property’s income and expense represents market, the expert compared its patient mix with that of Franklin Care Center, in Franklin (Somerset County); Medford Care Center, in Medford (Burlington County) and Regent Care, in Hackensack (Bergen County) for years 2007 through 2012. He omitted any evidence of revenue at the facilities, but instead provided the breakdown of revenue sources which he opined “demonstrates that the Subject’s mix of revenue is consistent with the market.” Neither revenue nor the actual per bed rates were provided.

With proof of the facilities’ revenue lacking, this court examined the data the expert provided regarding the patient mix. The percentage of each payer type at the Subject Property

differs from the properties offered in comparison and the mix within each facility varied from year to year. For instance, at Franklin Care Center the number of Medicaid patient days ranged from 79% to 81% percent over the years considered. At Regent Care Center the number of Medicaid patient days ranged from 52% to 72% during the same period. At Medford Care Center the number of Medicaid patient days ranged from 71% to 78%. At the Subject Property, the Medicaid patient days over the same period ranged from 68% to 73%. The expert's study also revealed a large difference in the percentage of Medicare patient days at the facilities on a yearly basis. At the Subject Property, the range of Medicare days over the same period ranged from 11.4% to 18.9%, but at Franklin Care Center the range was 6.5% to 9.7%. At Regent Care Center the number of Medicare patient days ranged from 16.2% to 25.4% while at Medford Care Center the range was 8.8% to 12.3%, and the percentage of Medicare patient days increased year-to-year between 2007 and 2011 then leveled off in 2012. The data did not reveal consistency between the payer mix at the Subject Property and the market, rather, it revealed variance in the payer mix year to year at each facility. (See Addendum, Chart 1).

Taxpayer points to the Owner's testimony as support for "a steady patient mix" at the Subject Property. As to Medicaid, the Owner stated that the "number of beds" (versus patient days) for each year varied (between 95 to 104 out of 129 total) but remained "relatively even" at about 75%. Such information does not assist the court's conclusion whether the mix at the Subject Property is market since the same data point was not provided for the other three properties, so no comparison is possible. Consistent in the testimony of both witnesses is the Subject Property's changing patient mix year to year affecting revenue, the same issue faced by the taxpayer in Twin Oaks and a factor that led that court to reject the income approach to value.

Moreover, none of properties offered as comparable are located within the Subject Property's competitive market. Medicaid and Medicare rates vary county to county and the location of the comparable facilities selected by the expert differ by county. As per the Owner's testimony, the Essex Medicaid rate is considerably lower than the Bergen Medicaid rate, obviating the establishment of a Medicaid market rate across counties. That kind of evidence weighs against the opinion of Taxpayer's expert that market income should be determined by reference to the entire state of New Jersey rather than the Subject Property's ten to fifteen-mile competitive radius. Moreover, the Medicaid rate at the Subject Property will continue to vary year to year as the improvement ages, a pattern affecting Medicaid at all nursing homes. As stated in the Appraisal of Nursing Facilities, 151, in discussing private pay revenue, "[i]t is important to learn what services and supplies are included in the basic rate as these can vary substantially within markets." Here, the record lacks evidence of the patient services provided for each facility. Nor does the PWC report on Medicaid and the nursing home industry assist Taxpayer in establishing an economic rent since it consists of general information with no evidence that the data is tailored to the Subject Property's market. The successful use of actual income to value a nursing home must include a method for measuring whether the income represents the market.

The record provides inadequate support to find the Subject Property's actual income is "stable and consistent" with the market. This finding comports with 962 River Ave., LLC, where the Tax Court rejected the taxpayer's income approach as flawed. That case included the revenue from comparable facilities, but not their payer mix, implying that a viable approach would compare both actual income and payer mix to determine whether the property's income reflects the market. Here, Taxpayer's expert essentially capitalized the Subject Property's actual income, as opposed to market income. That approach is problematic because it may lead to assessments that are

volatile rather than stable. For instance, if the Subject Property experienced a year of high income and low expenses the assessment could change dramatically even in an otherwise stable market. “Uniformity of assessment requires that all income-producing properties be valued based on their economic rent, not their actual rent.” Twin Oaks, 9 N.J. Tax at 395 (citation omitted).

Taxpayer’s expert compared the expense ratios of the Subject Property to one year of revenue and expenses at four continuing care communities (the Cliffs, The Daughters of Miriam, Allendale, and Prospect Heights) a mix of nursing homes and assisted living facilities, and opined that the Subject Property’s expenses fell within market expense ratios. No adjustments were made for location, time, or other factors, nor were expense comparables the same as those used to corroborate market income. Effective cross-examination revealed more differences than similarities when attempting to align the comparable properties with the Subject Property.

The Cliffs is a new assisted living facility which was “until recently” all private pay. The expert explained it has a “different quality of care,” resulting in salary expenses that differ from the Subject. He likewise was uncertain about the comparability of other expenses (e.g. utilities) and acknowledged that the facility does not serve as a comparison.

The Daughters of Miriam is a not-for-profit facility that yielded a negative net income. The expert described expenses as “a little bit of an artificial contrivance” or over-stated. Patients were offered Alzheimer care, hospice, and daycare, services not offered at the Subject, and Taxpayer’s expert was unable to explain the type of patient service that generated the source of income he listed as “FAWS.”

Allendale, is a combination assisted living/nursing home, but the financial reports do not delineate which expenses are attributed to the nursing home versus the assisted living, except the expert testified that the expense for “nursing” applied to the nursing home. The expenses also

included “non-departmental” which the expert could not explain, and “doubtful accounts,” which the expert testified “could be the same as” collection loss.

Prospect Heights is a high-rise nursing home that does not accept Medicaid patients. Taxpayer’s expert acknowledged that due to the facility’s location in Bergen County it would not compete with the Subject, since it would be atypical for an Essex County resident to select the Bergen County facility for care.

The expert also acknowledged that he was unable to use all the expenses for each comparable due to the different uses and services offered by the facilities. For example, the expert could not compare salaries at The Cliffs to the Subject Property because the facility employs differently trained professionals who are paid on a different pay scale. Similarity of underlying expenses to the Subject Property is important where the expert’s analysis relies on comparison of market ratios. On cross-examination the expert admitted that he could not testify to which specific categories at which facility he used to corroborate a particular expense. He explained he used the expense comparables as a corroborative source since “I don’t think there is any better proof than the subject.” The expert identified a “typical” profit range for nursing homes of 2.4% to 17.5%, but any information he used in determining the range was not made part of his report. For use in the income approach, Taxpayer’s expert adopted an expense figure of approximately 10% which he found fell within national Medicare data, and Senior Housing surveys that combined the data from various Continuing Care Retirement Communities. Because the survey information was not limited to nursing homes, nor to properties located in New Jersey, it does not credibly support a finding that the Subject Property’s actual expenses are consistent with the market.

An additional flaw affects Taxpayer's expert's opinion of value under the income approach. Nursing-home revenue is derived both from business operations and real estate and is not easily separated, as the court reflected on in Twin Oaks.

Proprietary nursing homes have unique characteristics which make it difficult to estimate their market value. Real estate alone is not the primary income producer as in an apartment house. Income is produced by a combination of the real estate, the personal property, which includes furniture, fixtures and equipment, and the services rendered by the staff, including food, 24-hour nursing services and activities for the patients. There is a limited market for proprietary nursing homes, and the real estate has limited alternate uses. The ability of the nursing home property to produce income is the source of the value of the real estate, but the income approach and market approach suffer the disability of combining the value of the real estate with the value of the business conducted in the real estate. The income depends on the mix of private and Medicaid patients and the efficiency of management in maximizing income and minimizing expenses.

[Twin Oaks, 9 N.J. Tax at 394 (citation omitted).]¹¹

Tax assessments are based solely on the value of the real estate. It is undisputed that the total income generated by the Subject Property is attributable both to the real estate as well as services unrelated to the real estate, e.g. round the clock nursing care by skilled staff, feeding residents, assisting with resident activities. Taxpayer's expert extracted out a determined value for non-realty FF&E, but there was no attempt to separately allocate value among the realty versus the value of the business operation. Taxpayer's income approach thus "suffer[s] the disability of

¹¹ The taxpayer's expert in 962 River Ave., LLC deducted a management fee intended to represent income attributable to the business, but it was rejected by the court. The court found the estimate was not market based where it relied on management contracts for apartment buildings. "The expectations of managing an apartment building . . . and the expectations of managing a nursing and rehabilitative facility . . . are too divergent to be comparable for purposes of estimating a management fee." 30 N.J. Tax at 307-08.

combining the value of the real estate with the value of the business conducted in the real estate.” Twin Oaks, 9 N.J. Tax at 394.

B. Cost Approach

The court finds that the valuation under the cost approach is the more reliable method to value the Subject property in this case. “Where there is no evidence of economic rent or comparable sales, the cost approach is the only method by which to value the property uniformly with other properties in the taxing district.” Id. at 395. In utilizing the cost approach “a value indication is derived for the fee simple estate by estimating the current cost to construct a reproduction of (or replacement for) the existing structure” next “including an entrepreneurial incentive or profit; deducting depreciation from the total cost and adding the estimated land value.” The Appraisal of Real Estate, 562 (14th ed. (2013)).

Initially, the court rejects the replacement cost new developed by the Taxpayer’s expert and West Caldwell’s second expert since their reliance on the M&S software was unsubstantiated. This court has previously considered and disfavored use of the M&S SwiftEstimator software in deriving the unit costs. The court requires that the inputs and additional data used by the software must be provided to allow review by the court. TD Bank v. City of Hackensack, 28 N.J. Tax 363, 405-06 (Tax 2015). Each step in the process must be documented since it is possible for the computer software to produce different results than if the same process is done by hand. Ibid. Such stringent requirement is valid since it is necessary both to confirm that the court has reached the correct conclusion of the property’s value and to ensure compliance with the constitutional requirement of fair assessments. “To date there has been no demonstration in any court that the calculations produced by the software are reliable.” Palisadium Management Corp. v. Borough of Cliffside Park, 29 N.J. Tax 245, 263 (Tax 2016), aff’d, 456 N.J. Super. 293 (App. Div. 2018). In

Palisadium, the court described how “the [] expert indicated that he ‘plugged in’ the numbers into the program and did not independently check any of the resulting calculations to determine their accuracy vis-à-vis the Marshall & Swift hand calculations historically accepted by the court.” Id. at 263.

Forsgate Ventures IX, LLC v. Township of South Hackensack, serves as another instance of this court’s rejection of reliance on the software-based unit costs. 29 N.J. Tax 28, 45 (Tax 2016), aff’d, 31 N.J. Tax 135 (App. Div. 2018). There, the Tax Court rejected the expert’s cost estimate where the party “did not produce independent testimony to authenticate and explain the calculations used by the automated valuation software.” Id. at 45. The court explained:

In order for a new technology to be deemed reliable, there must be sufficient scientific basis to produce uniform and reasonably reliable results and [the technology] will contribute materially to the ascertainment of the truth. The automated valuation software may be useful in terms of streamlining the valuation process, but the court is unable to ascertain the underlying data, basis, or reasoning in the generation of such estimates. In other words, without a detailed explanation of the valuation software used, the court has no way to gauge the accuracy or reasonableness of the estimates produced.

[Ibid. (internal quotation marks and citation omitted).]

In calculating the replacement cost new of the Subject Property, both Taxpayer’s expert and West Caldwell’s second expert elected to use the M&S, SwiftEstimator software. Neither expert was knowledgeable about the workings of the software or how the program performs the cost calculations. Both experts input certain property parameters into the computer program which applied additional data to calculate the overall building cost new. Neither expert produced evidence to confirm the validity of the results through manual calculation or through the production of actual construction costs to compare the experts’ conclusions reached using the M&S software. Taxpayer’s expert was unaware whether the numbers the computer reported

would be the same if he calculated them manually, and never attempted to do so. This court shares the same concerns voiced previously by the Tax Court as to the reliability of the computer program and the need for a detailed explanation of how it operates.

Like Taxpayer's expert, West Caldwell's second expert produced two reports reflecting the calculation of different base unit cost estimates. Neither expert provided a reason for the difference in the replacement cost estimate or testified which figure was correct. Both experts relied on the second summary report without reconciling the difference. They offered no reason why the computer generated two different cost estimates when the identical data was input into the program. Having rerun the report, Taxpayer's expert testified "[t]he program recalculates and does not come up with the exact same unit prices . . . it's some internal machination. Nothing that I touched or manipulated." In each instance, since the individual components and multipliers are contained within the computer software, the court is unable to determine which calculation is accurate. The computer performs the mathematic calculations. Without the underlying data and calculations utilized by the computer program, the court is unable to accept the M&S software as a valid and reliable method of analysis or to rely on the unit-cost estimate produced by it.

Because the court rejects the income approach as unreliable, as with value conclusions of replacement cost now reached by use of the SwiftEstimator computer software, there is no evidence from which the court may determine value as to tax years 2008, 2009, 2010, 2013, and 2014. The assessments as to those years are affirmed due to a failure of proofs.

However, West Caldwell's revaluation expert utilized the M&S cost calculator and derived his opinion of value and depreciation by manual calculation rather than through use of the computer software, for tax years 2011 and 2012. The court will consider that evidence along with evidence of depreciation and of land value produced by all three experts.

i. Land Value

The court accepts the per bed measure utilized by Taxpayer's expert to derive the value of the land,¹² along with Taxpayer's expert's land Sales 1, 2, 3 and 5. The expert testified that he verified each transaction with one of the participants to the sale and found the sales to be arms-length transactions. Sale 1 is 339-61 Eagle Rock Avenue, Roseland (common to all three experts). Per Taxpayer's expert it had approvals for development of an 85-bed assisted living facility. On cross-examination, West Caldwell challenged the expert's bed count and referenced a State web site that purported to show the facility was licensed for 100 beds. There was no indication on cross-examination whether the 100-bed count was effective for the tax years at issue. Absent such proof the court finds the inference raised lacks support and accepts the testimony of Taxpayer's expert. The expert applied a negative 10% adjustment to this sale since the number of beds was less than at the Subject Property but applied no adjustment for approvals, finding it like the Subject Property in that regard. The expert opined an adjusted per bed value of \$28,282 for Sale 1. West Caldwell's second expert opined that the property was sold subject to approvals later obtained, and the revaluation expert was unsure about the status of approvals (although he provided a +33% adjustment for this). The court therefore accepts Taxpayer's expert's testimony as reliable as to lack of adjustment for approvals and accepts the bed count adjustment.

¹² There are several reasons the court accepts the per bed unit of measure. The experts each selected a different measure, but the market-place industry standard was not established. See 962 River Ave., LLC, 30 N.J. Tax at 308 (per unit); Twin Oaks, 9 N.J. Tax at 394 (acreage). While each expert provided a reasonable basis for the measure utilized, the court determined not to adopt acreage as a unit measure since the acreage provided by the experts for the two common sales differed. Absent reliable evidence of the correct acreage the sales would not have been usable. Moreover, the court sought to maximize the number of reliable land sales for use in deriving value which results in use of Taxpayer's expert's land sales.

Sale 2, 360 Glen Road, Woodcliff Lake, sold with approvals for development of an assisted living facility with 160 beds and the expert made no adjustments to the sale. The property sold for \$22,813 per bed. Like 339-61 Eagle Rock Avenue, the sale was consummated December 2011, so two months after the second valuation date and fourteen months after the first. The court finds that the December sale dates are not too remote from the dates of valuation and they provide reliable evidence of the land value.

Sale 3, 100 Plainsboro Road, Plainsboro, sold in March 2009 for development of a 200-bed nursing home. All three experts utilized the sale and agreed that the property sold with development approvals. Taxpayer's expert found no adjustments to the sales price was warranted which the court accepts. The property sold for \$15,625 per bed. The court accepts the sale as comparable despite the difference in location from the Subject Property since all three experts agreed it was the only property sold for development of a nursing home during the relevant period. Taxpayer's expert found no empirical evidence to adjust any of the comparable sales for their location outside of Essex County.

The court will eliminate Taxpayer's expert's Sale 4 (780 Old Franklin Road) since the sale date of February of 2013 represents post-assessment data well removed from the valuation dates.

Sale 5, located at 89 Ave at the Common, Shrewsbury, sold with development approvals for a 140-bed assisted living facility. The property sold in June 2004, but the expert found no time adjustment was warranted. The property sold for \$7,500 per bed. The court affords that sale little weight due to its remoteness from the valuation dates, and further considers it to be an outlier. The expert placed the most weight on Sale 1 in Roseland (common sale). He explained that his concluded \$25,000 per bed value falls at "the upper end of the market" but in his experience it reflects a reasonable per bed value for Western Essex County. The court accepts

the land value of \$25,000 per bed or \$4,500,000 opined by Taxpayer's expert as of October 1, 2010 and October 1, 2011.

Finally, the court rejects West Caldwell's revaluation expert's Sale 1, at 1086 Dumont Drive, Vorhees, sold in October 2004, as being too far removed from the valuation dates for tax years 2011 and 2012 (October 1, 2010 and October 1, 2011, respectively.)

ii. Replacement Cost New

West Caldwell's revaluation expert divided the building into five sections to reflect the cost of the first floor, second floor, basement-finished and unfinished, and maintenance building. He selected Building Class B, Building Quality "Good," for the first and second floors. For the basement area, constructed of concrete block, the expert selected Building Class C, Building Quality "Average". The court finds that the building class selected from the M&S manual comports with the composition of the Subject Property's structure (steel and brick over concrete block). Cross-examination establishing as unreasonable the expert's judgment of the improvement's class/characteristics as compared with the M&S description, is lacking. The revaluation expert underwent cross-examination regarding his selection of building quality "good" versus "average" for above-ground areas that would result in a higher overall replacement cost. The expert's selection of building quality was based on the types of finishes he observed and his judgment regarding the condition of the Subject Property as compared to other nursing homes he has inspected. The court finds the building quality selected is credible given the work performed under numerous permits opened for maintenance and improvements to the building, and the statement in the written report of Taxpayer's expert pointing out "significant maintenance and repair costs, suggesting the quality of upkeep at the subject property."

Taxpayer's expert's criticism of the "good" building quality finds little support in the record. For instance, when opining on effective age Taxpayer's expert testified that the 20-year effective age he selected for all tax years paralleled the chronological age because there were no substantial capital improvements to the property, based on the Owner's testimony. The expert testified that when he saw the property in 2001 then again in 2013 it was the same but for minor changes such as wallpaper and other cosmetics, but nothing had been done to materially affect age of the building. Effective cross-examination revealed that the expert was unaware of permits that had been taken out for work on the building. When asked about the dialysis area in the basement (while not operational for the years under appeal) the expert was unaware of its existence which effects the expert's credibility regarding conditions at the property. The court accepts West Caldwell's revaluation expert's selection of building class and quality as reliable, and his corresponding selection of base unit cost in this regard.

As noted, in arriving at the expert's replacement cost new, the court substituted the correct multipliers as per the expert's testimony, which reduced the overall replacement cost new of the improvement. To the cost new, the revaluation expert added indirect or "soft costs" calculated as 5% of the replacement cost new. "Both direct and indirect costs are essential to a reliable cost estimate." The Appraisal of Real Estate, 571 (14th ed. 2013). The soft costs represent the cost of obtaining the loan which he opined would be between two and five points. He selected three points, or 3%, as the average. To that he added 2% for the cost to carry the property during the construction period. He also added 10% entrepreneurial profit. Entrepreneurial profit "represents the difference between the total cost of a property (cost of development) and its market value (property value after completion), which represents the [] risk and expertise associated with

development.” *Id.* at 573. The court accepts the expert’s percentages for both soft costs and entrepreneurial profit.

iii. *Depreciation*

a. *External obsolescence*

Only Taxpayer’s expert provided for depreciation on account of external obsolescence.

“External obsolescence is a loss in value caused by negative externalities, i.e. factors outside a property.” *The Appraisal of Real Estate*, 632 (14th ed. 2013).

“External obsolescence usually has a marketwide effect and influences a whole class of properties” though it can affect a single property when the value loss is based on a property’s location, such as “proximity to negative environmental factors or the absence of zoning and land use controls” as well “heavy traffic, a landfill, or other undesirable land use outside of the property.” *Ibid.* “Most properties experience market obsolescence from time to time as a result of the natural expansion and contraction of the real estate market.” The term “economic obsolescence” is sometimes used “because economic factors outside the control of property owners, like mortgage interest rates and changing employment levels, can have large effects on the value of real estate.”

[*Ibid.*]

Our courts have recognized that “[e]xternal obsolescence may be estimated by allocation of market-extracted depreciation, market data analysis, or capitalization of income loss.” *Regent Care c/o, Prudential Asst. v. City of Hackensack*, 27 N.J. Tax 138, 156 (Tax 2013) (citing *The Appraisal of Real Estate*, 443 (13th ed. 2008)). In finding that the Subject Property suffers from external obsolescence the expert relies on his calculation that Medicaid income per bed is on average 22% less than private pay, and that the Medicaid rate is declining 2% per year. The testimony offered to support his opinion does not comport with the record. Regarding Medicaid dollars per bed received by the Subject Property the court was unable to reconcile the expert’s reported figures to reflect the yearly 2% decrease described, and any decreases that occurred did

not necessarily affect each year under appeal. While the record reveals a decrease in the Medicaid reimbursement some years, it reflects an increase in others. The 2010 dollars per Medicaid bed at the Subject Property was higher than all three prior years (of those years 2008 and 2009 are under appeal). Medicaid income saw a decrease in 2011 and 2012 then increased once again in 2013, and there is no “rate” discernable from the evidence. The chart relied on by the expert is reproduced from his report, below.

Tax Year	2007	2008	2009	2010	2011	2012	2013
Medicaid Payment/bed	\$202	\$208	\$207	\$210	\$205	\$202	\$204

Taxpayer’s expert’s second basis for external obsolescence lies in his testimony about the cost of construction. He opines that use the cost approach to value the Subject Property assumes income that is unregulated. The opinion fails to find support in the record given that no actual assumption of construction costs was entered into evidence to support the premise. Even assuming a basis for external obsolescence, the court finds that in measuring the depreciation Taxpayer’s expert applied a flawed methodology, and one not recognized by the courts. The expert calculated the difference between the actual revenue, and potential revenue of the facility at all private pay, and at full occupancy. The expert then applied the percentage difference to his replacement cost new, instead of determining an appropriate rate and capitalizing the perceived income loss. The Appraisal of Real Estate, 635 (14th ed. 2013) (measure of external obsolescence is through “capitalization of income loss due to the effect of the externality.”) Moreover, he testified that his method reflected the “reality” of what occurred at the Subject Property, yet the calculation excluded any consideration of Medicare, the highest daily rate of the three sources of income, and there was no explanation for the omission. In his reliance on actual revenue the expert factored in a 25% vacancy rate rather than using potential income reduced by a vacancy rate obtained from the market.

To further support the depreciation analysis, the expert compared Medicaid to rent control, stating, “[l]ike rent control Medicaid payments limit the income potential of a property and therefore similar to other governmental restrictions may affect market value.” In his opinion, just as rent-control apartments are not subject to market rates, Medicaid eliminates “the flexibility of going to the market and getting market rates. . . since the government sets the rates the rental loss is a prototypical and the standard measure of obsolescence.” The expert continued, “[t]he public policy of accepting Medicaid patients is clearly beneficial to the purpose of promoting affordable health care for the elderly who could not otherwise afford it.” In his opinion, “it’s only fair in this case that the public should share the burden of market-place consequences of a nursing home-owner accepting a significant and stable number of Medicaid patients at below Medicare and private pay rates.” Credible testimony from West Caldwell’s second expert serves to refute the theory, where he explained that income derived from an apartment is wholly attributable to the realty, whereby the actual net income loss due to rent control can be assigned to the improvement, capitalized, and deducted.

Taxpayer further cited to case law where governmental restrictions on the transfer and ownership of land impair the value of the land. Prowitz v. Borough of Ridgefield Park, 237 N.J. Super. 435 (App. Div.), aff’d 122 N.J. 199 (1991) (in tax appeal filed by affordable housing unit owners court found affordable housing law affects property value where law restricts the units’ resale price). Some government regulations, such as those that limit what can be done a specific parcel of land, may affect the value of a property. County of Bergen v. Borough of East Rutherford, 12 N.J. Tax 399, 413 (Tax 1992) (municipality’s assessment exceeded the property’s true value due to effect of statutory environmental restrictions limiting the use of the property), aff’d, 265 N.J. Super 1 (App. Div. 1993). There is no evidence for the court to find that the rules

establishing the Medicaid reimbursement rate for nursing home patient care, in any manner governs, restricts, or limits the transfer and ownership of the land. The court is likewise unpersuaded that the receipt of Medicaid revenue equates to a public policy that should be shared by the taxpayers in form of reduced property taxes for nursing homes, where one government regulation restricts an owner from collecting market rent and the other is a form of government-controlled health insurance that serves as a guaranteed source of nursing home revenue. “Where a taxpayer’s expert fails to establish a basis for the deduction of economic obsolescence, the court may decline to make a deduction for it.” Regent Care, 27 N.J. Tax at 156-57.

b. Functional obsolescence, curable and incurable

“Functional obsolescence is caused by a flaw in the structure, materials, or design of the improvement when compared with the highest and best use and most cost-effective functional design requirements at the time of the appraisal.” The Appraisal of Real Estate, 623 (14th ed. 2013). “Functional obsolescence . . . may be curable or incurable . . . caused by a deficiency, that is, some aspect of the subject property is below standard in respect to market norms” or it can be “caused by a superadequacy, that is, some aspect of the subject property exceeds market norms.” Ibid. Taxpayer’s expert’s opined 5% curable obsolescence. His testimony that modern nursing homes contain the items cited (in-room temperature control, in-room oxygen, relocation of elevators, video security) was met with criticism on cross-examination for failure to provide sufficient proof of his conclusion since the largest percentage of nursing homes the expert used as comparison were not modern. In calculating the amount of depreciation, Taxpayer’s expert relied on M&S for the cost of the items, including installation, and converted the figure to a percentage. The court finds that the expert’s depreciation conclusion is based on testimony that is credible, see Regent Care, 27 N.J. Tax at 155-56 (accepting lack of direct oxygen pumped into patient rooms

listed by expert as a physical deficiency), and will apply 5% depreciation for curable functional obsolescence.

Only Taxpayer's expert concluded that the Subject Property suffered from incurable functional obsolescence. The opinion is based on occupancy rates at the Subject Property during the years under appeal that averaged around 75%. The expert contends the rate is market-based since the same vacancy factor can be found at four of the Owner's other nursing homes, and a figure the Owner explained is typical of the nursing home market "in general." If it were today, the Owner would build a smaller nursing home with 100 beds, and private rooms only, a trend he has seen develop over the last 10-15 years. That serves as the basis for the expert's depreciation theory that the Subject Property suffers from a superadequacy in a market he finds to be adversely affected by competition from assisted living and other forms of continuing care communities. But the analysis lacks proof connecting the Subject Property's vacancy to the real estate versus operation of the business. In addition, the Owner's four nursing homes are located outside the Subject Property's market. While the expert contends that "statewide vacancy rates" support his theory, neither the rates nor the properties he relies on for that proposition are in evidence. All three experts utilized as a land comparable, property sold in 2009 for a nursing home approved for 200 beds, contrary to the Owner's testimony regarding the trend toward the development of smaller nursing homes. Further, the Certificate of Need for 180 beds has continued at the Subject Property unchanged year to year since 1987. The court finds reliable evidence of incurable functional obsolescence at the Subject to be lacking.

c. Physical depreciation

In calculating physical depreciation, the court will only consider West Caldwell's revaluation expert's conclusions having found the M&S software used by Taxpayer's expert to be

unreliable. West Caldwell's revaluation expert provided the sole estimate of depreciation for the years under the court's review, which as noted above was 24% and 26% for tax years 2011 and 2012, respectively, under the economic age/effective life method, opining that the general maintenance of the Subject Property over the years was very good. The court finds the expert's opinion of effective age to be well founded and finds support in permits taken out on the Subject Property between 2009 and 2012 that total over \$1 million. Also, permits dated during the ten years prior to 2008 and after the valuation dates elicit a pattern of maintenance, upgrades, and repairs at the property. The court agrees with West Caldwell that these "permits demonstrate a propensity for taxpayer to maintain and upgrade the property in a manner which would likely reduce its effective age." The court will apply total depreciation of 29% for 2011 (5% functional curable and 24% physical) and total depreciation of 31% for 2012 (5% functional curable and 26% physical).

The property assessment for both tax years 2011 and 2012 is \$16,200,000. Because the town underwent a revaluation in 2011 the ratio is 100%. The total value for tax year 2011 is \$18,449,677 (\$18,500,000 rounded), when adding the value of the land (\$4,500,000) to the replacement cost new of \$13,949,677. Because West Caldwell did not file a counterclaim, the court cannot increase the assessment. See Elrabie v. Borough of Franklin Lakes, 24 N.J. Tax 158 (Tax 2008). Therefore, the 2011 assessment is affirmed. The ratio for tax year 2012 is .9541, with a common level range of .8109 to 1.0. The total value for tax year 2012 is \$18,565,527 (\$18,600,000 rounded), when adding the value of the land (\$4,500,000) to the replacement cost new of \$14,065,527. The ratio of assessed value is .8709 ($\$16,200,000 \div \$18,600,000$) and falls within the common level range. Therefore, the 2012 assessment is also affirmed.

The Clerk of the Tax Court is directed to enter judgment affirming the assessments for all years under appeal.

ADDENDUM
Chart 1- Payer Mix

WEST CALDWELL CARE CENTER
 (Eagle Block Convalescent Center)
 CENSUS/RATE HISTORY (2007-2012)
 165 Fairfield Avenue, West Caldwell, New Jersey- Block: 1200 Lot: 2

Census and Payer Mix:

	2007		2008		2009		2010		2011		2012	
	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%
Private	7,396	13.30%	4,933	9.90%	6,155	12.20%	6,371	12.50%	5,916	12.50%	4,599	9.70%
Medicare	9,718	17.40%	9,418	18.90%	8,124	16.50%	6,956	13.70%	6,264	13.20%	5,408	11.40%
Medicaid	37,920	68%	34,948	70.20%	35,479	70.40%	36,486	71.80%	34,612	71.80%	34,981	73.90%
Other	750	1.30%	512	1%	616	1.20%	973	1.90%	681	1.40%	2,366	5%
Total	55,784		49,811		50,374		50,788		47,473		47,354	

FRANKLIN CARE CENTER
 CENSUS HISTORY
 3371 Rt 27, Franklin, New Jersey- Block: 32 Lot: 1.01

Census and Payer Mix:

	2007		2008		2009		2010		2011		2012	
	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%
Private	3,016	8.50%	3,521	10.70%	3,298	11.20%	3,426	11.20%	2,353	8.50%	2,367	9.40%
Medicare	3,461	9.70%	2,641	8.00%	2,070	7.00%	1,969	6.50%	2,576	9.30%	1,606	6.40%
Medicaid	28,755	80.7%	26,729	81.00%	23,825	81.00%	24,320	79.80%	22,641	81.80%	20,764	82.70%
Other	421	1.20%	113	0.3%	175	0.60%	745	2.40%	103	0.40%	374	1.5%
Total	35,653		33,004		29,368		30,460		27,673		25,111	

MEDFORD CARE CENTER
 CENSUS HISTORY
 185 Tuckerton Rd., 122 & 124 Taunton Rd, Medford, New Jersey- Block: 2702.01 Lots: 8, 9, & 11

Census and Payer Mix:

	2007		2008		2009		2010		2011		2012	
	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%
Private	6,531	12.60%	5,170	10.80%	5,090	11.70%	3,987	9.50%	3,734	9.60%	6,039	14.70%
Medicare	4,576	8.80%	4,552	9.50%	4,438	10.20%	4,873	11.60%	4,819	12.30%	4,524	11.00%
Medicaid	39,743	76.6%	37,702	78.40%	33,351	76.50%	32,187	78.50%	29,710	76.10%	29,430	71.50%
Other	1,009	1.90%	652	1.4%	733	1.70%	1,054	2.50%	763	2.00%	1,178	2.9%
Total	51,859		48,076		43,612		42,101		39,026		41,171	

REGENT CARE CENTER
 CENSUS HISTORY
 336 Prospect Avenue, Hackensack, New Jersey- Block: 341 Lot: 10

Census and Payer Mix:

	2007		2008		2009		2010		2011		2012	
	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%	Patient Days	%
Private	9,954	17.30%	8,145	16.00%	4,991	10.30%	4,636	9.50%	4,289	9.10%	3,622	7.90%
Medicare	14,566	25.40%	10,460	20.50%	8,347	17.20%	8,901	18.20%	7,969	16.80%	7,384	16.20%
Medicaid	29,907	52.1%	30,767	60.30%	33,064	68.20%	33,757	68.90%	31,283	66.10%	33,154	72.80%
Other	2,989	5.20%	1,620	3.2%	2,052	4.20%	1,734	3.50%	3,803	8.00%	1,403	3.1%
Total	57,426		50,992		46,454		49,028		47,344		45,563	

Chart 2
Taxpayer's Expert's Opinions of Value

Tax Year	Cost Approach Initial Value (2013 Summary Report)	Cost Approach Revised Value (2015 Summary Report)	Income Approach Value	Reconciled Value
2008	\$8,305,000	\$10,470,000	\$5,640,000	\$6,500,000
2009	\$8,530,000	\$10,910,000	\$5,785,000	\$6,500,000
2010	\$8,335,000	\$10,575,000	\$6,015,000	\$6,500,000
2011	\$8,450,000	\$10,745,000	\$5,920,000	\$6,500,000
2012	\$8,600,000	\$10,980,000	\$6,200,000	\$6,500,000
2013	\$8,815,000	\$11,135,000	\$4,780,000	\$5,500,000
2014	\$8,910,000	\$11,340,000	\$4,710,000	\$5,500,000

Chart 3
Taxpayer's Expert's Land Sale Comparables

	Sale 1 339-361 Eagle Rock Roseland	Sale 2 360 Glen Rd Woodcliff Lakes	Sale 3 100 Plainsboro Rd. Plainsboro	Sale 4 780 Old Franklin Rd. Franklin	Sale 5 89 Ave at the Commons Shrewsbury
Sales price	\$2,671,115	\$3,650,000	\$3,125,000	\$1,500,000	\$1,050,000
# Approved beds	85	160	200	161	140
Sale Date	12/8/11	12/29/11	3/24/09	2/12/13	6/28/04
Size (acres)	3.67	4.70	5.20	5.03	3.26
Financing terms	Market	Market	Market	Market	Market
Conditions of Sale	Arms-length	Arms-length	Arms-length	Arms-length	Arms-length
Price Per bed:	\$31,425	\$22,813	\$15,625	\$9,317	\$7,500
Adjustments Size (# of beds)	-10%	0	0	0	0
Net Adjustment	\$267,112	0	0	0	0
Adjusted Price Per bed:	\$28,282	\$22,813	\$15,625	\$9,317	\$7,500

Chart 4
West Caldwell's Second Expert's Opinions of Value (Cost Approach)

Tax Year	2013 Summary Report	2015 Summary Report
2008	\$15,850,000	\$16,660,000
2009	\$16,295,000	\$17,210,000
2010	\$15,560,000	\$16,670,000
2013	\$16,030,000	\$17,240,000
2014	\$16,240,000	\$17,740,000

Chart 5
West Caldwell's Revaluation Expert's 2011 Replacement Cost New (before adjustments including depreciation)

	Section I Convalescent Hosp/ Nursing Home Floor1	Section II Convalescent Hosp/Nursing Home Floor2	Section III Convalescent Hosp/Nursing Home Finished Basement	Section IV Convalescent Hosp/Nursing Home Unfinished Basement
Refined Sq. Foot	185.03	173.18	69.02	25.89
Current Cost Multiplier	1.06 *1.04	1.05 *1.04	1.06	1.06
Local Multiplier	1.26 *1.25	1.28 *1.25	1.26 *1.25	1.26 *1.25
Final Square Foot Cost	\$247.12 **240.53	\$232.75 **\$225.13	\$92.19 **\$91.45	\$34.58 **\$34.30
Area	36,034	33,433	5,283	5,283
Final Section Cost	\$8,904,901.62 **\$8,667,582.33	\$7,781,490.41 **7,526,905.02	\$487,036.55 **\$483,138.27	\$182,703.59 **\$181,229.35
Lump Sums	\$150,436.20	0	0	0
Replacement Cost New	\$9,055,337.82 **8,818,018.53	\$7,781,490.41 **\$7,526,905.02	\$487,036.55 **\$483,138.27	\$182,703.59 **\$182,703.59

*Reflects expert's correction.

** Reflects court's calculation based on expert's corrections. (Total \$17,010,765).

Chart 6
West Caldwell's Revaluation Expert's 2012 Replacement Cost New (before adjustments including depreciation)

	Section I Convalescent Hosp/ Nursing Home Floor1	Section II Convalescent Hosp/Nursing Home Floor2	Section III Convalescent Hosp/Nursing Home Finished Basement	Section IV Convalescent Hosp/Nursing Home Unfinished Basement
Refined Square Foot	185.03	173.18	69.02	25.89
Current Cost Multiplier	1.09 *1.08	1.07 *1.08	1.09 *1.08	1.09 *1.08
Local Multiplier	1.26 *1.25	1.26 *1.25	1.26 *1.25	1.26 *1.25
Final Square Foot cost	\$254.12 **\$249.79	\$233.48 **\$233.79	\$94.80 **\$93.07	\$35.56 **\$34.95
Area	36,034	33,433	5,283	5,283
Final Section Cost	\$9,156,927.13 **\$9,000,950.88	\$7,805,807.57 **\$7,816,401.37	\$500,820.60 **\$492,254.09	\$187,874.44 **\$184,648.77
Lump Sums	\$154,899.32	0	0	0
Replacement Cost New	\$9,311,826.46 **\$9,155,850.20	\$7,805,807.57 **\$7,816,401.37	\$500,820.60 **\$492,254.09	\$187,874.44 **\$184,648.77

*Reflects expert's correction.

**Reflects court's calculation based on expert correction. (Total \$17,649,154).

Chart 7
West Caldwell's Revaluation Expert's opinion of value

Tax Year	Initial Cost Approach	Cost Approach as Recalculated by the Court
2011	19,276,000	18,500,000
2012	19,128,000	18,600,000

Chart 8
Court's Value Conclusions

Tax Year 2011

Total Replacement Cost New	\$17,010,765
+ Soft costs at 5%	\$ 850,538
=	<u>\$17,861,303</u>
+ Entrepreneurial profit at 10%	\$ 1,786,130
= Total Replacement Cost	<u>\$19,647,433</u>
- (Physical 24%, Functional 5%)	(5,697,756)
= Improvement value	<u>\$13,949,677</u>
+ Land value	\$ 4,500,000
=Total	\$18,449,677
Rounded	<u>\$18,500,000</u>

Tax Year 2012

Total Replacement Cost New	\$17,649,154
+ Soft costs at 5%	\$ 883,047
=	<u>\$18,531,661</u>
+ Entrepreneurial profit at 10%	\$ 1,853,161
= Total Replacement Cost	<u>\$20,384,822</u>
- (Physical 26%, Functional 5%)	(6,319,295)
= Improvement value	<u>\$14,065,527</u>
+ Land value	\$ 4,500,000
=Total	\$18,565,527
Rounded	<u>\$18,600,000</u>