STATE OF NEW JERSEY
OFFICE OF THE STATE COMPTROLLER

INVESTIGATIVE REPORT

INEQUITABLE TAX ASSESSMENTS
BOROUGH OF EDGEWATER

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I. Introduction and Summary

The Office of the State Comptroller (OSC) received, investigated and ultimately confirmed allegations that a municipal tax assessor, without any supporting documentation, significantly reduced tax assessments to the benefit of a wealthy private developer (the Developer), in Edgewater, New Jersey. In so doing, the assessor, Mr. Arthur Carlson, treated the Developer more favorably than similarly situated private property owners, thereby increasing the tax burden for all Edgewater property owners.

Specifically, for the 2008 and 2009 tax years, Mr. Carlson reduced the tax assessments for Developer-owned condominium units by nearly triple the reductions received by other owners in the same development and, as Mr. Carlson ultimately admitted, to levels below market value. As a result, the Developer received an estimated $472,521.12 in disproportionate tax savings.

OSC's investigation raises concerns that municipal tax assessors, as Mr. Carlson demonstrated here, are able to significantly and inequitably alter tax assessments in a manner inconsistent with New Jersey Constitutional standards and state law without others ever becoming aware. Moreover, tax assessors are able to negotiate and effectuate tax assessment reductions with little or no transparency because tax assessors generally are not required to gather or maintain documentation supporting the reductions they negotiate. Significant increases in the number of tax appeals and volume of work before the County Boards of Taxation only add to the concern that municipal tax assessors are able to operate without the type of meaningful oversight that would prevent the type of abuse discovered here.

II. Methodology

OSC began its investigation in late 2010, following receipt of a complaint regarding inequitable tax assessment reductions granted to the Developer for condominium units it owned in City Place, a luxury development in Edgewater. In completing this investigation, OSC obtained and reviewed numerous documents and other information such as tax assessments, tax credits, tax appeals and tax judgments for units within the City Place development from 2008 through 2011. OSC requested and received these documents from entities and individuals including the Bergen County Board of Taxation (County Tax Board), Edgewater's Business Administrator, Mr. Carlson and the Developer's attorney (the Attorney). The investigation also included interviews with Mr. Carlson, Edgewater's Business Administrator, Tax Collector, Tax Assessor Clerk and Construction Official/Land Use Administrator, as well as state Division of Taxation (Division of Taxation) employees, the Attorney, the County Tax Administrator, and the Senior Field Representative/Office Manager of the County Tax Board. The investigation was conducted in accordance with generally accepted national standards for investigations as set forth by the Association of Inspectors General.

We provided a draft of this report to Mr. Carlson, the Edgewater Business Administrator, the Attorney, the County Tax Board and the Division of Taxation. We received written responses from Mr. Carlson, the Business Administrator, the Attorney and the Division of Taxation. The County Tax Board advised us that it would not be submitting a response. The responses we received were considered in preparing the final report and were incorporated herein where appropriate.

III. Background

A. The Development

City Place is a luxury development in Edgewater, New Jersey, on the Hudson River overlooking Manhattan. The development includes residential condominium units, townhouses, a hotel and ground-level retail shopping, dining and entertainment establishments. Each condominium is owned either by one of various developers or by individual residents who have purchased a unit from one of the developers. This report concerns only the particular City Place development known as the "Peninsula," which consists of residential condominium units. The retail establishments, townhomes and other condominium units within City Place are not at issue in this report.

B. The Developer

The Developer is a wholly owned subsidiary of an international corporation (the Corporation). The Corporation is headquartered in Bahrain and specializes in several lines of business, including real estate investment in the United States. The Corporation's fiscal 2011 net income was $140.3 million, and it has approximately $12 billion in assets under management. The Developer purchased the Peninsula in 2003, before the condominiums were completed. Upon its completion in 2007, the Peninsula consisted of 201 residential condominium units available for sale to private owners.

C. The Tax Assessor

Mr. Carlson is a tax assessor employed full-time by the municipality of Hackensack and has been employed there since 1992. In addition, Mr. Carlson has been employed as a part-time tax assessor in Saddle Brook since 1988 and in Ridgefield Park since 2008. With particular

relevance to this report, Mr. Carlson also was the tax assessor in the municipality of Edgewater from 2007 to June 30, 2011.

Mr. Carlson, like all tax assessors in New Jersey, is responsible for determining the full and fair value of real property in the taxing district. *See* N.J.S.A. 54:4-23. An "assessor's duty is to determine true value of the property being assessed . . . ." *Englewood Cliffs v. Estate of Allison*, 69 N.J. Super. 514, 529 (App. Div. 1961). That is, tax assessors are responsible for determining the amount that real property "would sell for at a fair and bona fide sale by private contract on October 1" of the preceding tax year. N.J.S.A. 54:4-23. The New Jersey Constitution specifically requires that all real property be assessed using the same standard of value. *See* N.J. Const. art. VIII, §1, ¶ 1(a). As the New Jersey Supreme Court has stated, "The fundamental approach of our statutes is that ordinarily all property shall bear its just and equal share of the public burden of taxation." *Princeton University Press v. Princeton,* 35 N.J. 209, 214 (N.J. 1961) (superseded on other grounds). While tax assessors are expected to use their judgment in assessing property, they must adhere to the state Constitution and to the statutes governing their profession.

Tax assessors report directly to the county boards of taxation and ultimately are overseen by the Division of Taxation. Tax assessors are not overseen or supervised by the municipality that employs them. County tax administrators, under the supervision and control of the county tax boards, are required to act as the day-to-day supervisors of the assessors, and tax administrators are responsible for overseeing the assessment function within the county. *See* N.J.S.A. 54:3-16.

IV. The Developer's 2008 Tax Assessment Reductions Lacked Transparency and Documentary Support

A. The Negotiations

Upon completion of the Peninsula condominium units in 2007, Mr. Carlson set tax assessments for each individual unit for the 2008 tax year. The Attorney, on behalf of the Developer, appealed the 2008 tax assessments for all 137 units the Developer had not yet sold. (The Developer already had sold 64 of the units to private owners by the time of its appeal.) According to the Attorney, a significant deterioration in the real estate market precipitated the appeals. The filing of these appeals led to a dialogue between Mr. Carlson and the Attorney. In interviews with OSC, both Mr. Carlson and the Attorney stated that they negotiated solely with one another; Mr. Carlson never had contact with a principal or other employee of the Developer.

Negotiations between Mr. Carlson and the Attorney included a proposal by the Attorney to reduce the tax assessment on 50 of the Developer-owned units by 20%. The remaining 87 Developer-owned units would, according to the proposal, receive a 20% reduction the following year, in 2009.

B. The Agreement

Along the lines of the Attorney's proposal, in 2008 the Developer received 20% reductions on 50 of the Developer-owned condominium units. The reductions were accomplished through judgments entered by the County Tax Board following agreement being reached between Mr. Carlson and the Attorney. Once Mr. Carlson informed the County Tax Board that an agreement had been reached, the judgments simply were issued in accordance with that agreement. Neither the Developer nor the Attorney appeared before the County Tax Board, nor were they required to do so since they had submitted a negotiated settlement for approval.

Mr. Carlson did not compile or maintain any documentation demonstrating a 20% drop in fair market value of the units.

In contrast to the treatment afforded to the Developer, the one private condominium owner in the Peninsula who appealed her 2008 tax assessment did not receive any reduction. Pursuant to standard appeal procedure, the private owner had appealed her assessment to the County Tax Board. The appeal included presentation of five comparable sales for the board to review. There is no indication in the appeal record that Mr. Carlson took any position with regard to the appeal. The County Tax Board issued a Memorandum of Judgment affirming the original assessment, which summarily indicated that the assessment was within an acceptable range. In contrast, a virtually identical Developer-owned unit, which originally had been assessed at the exact same dollar amount, received a tax assessment reduction of 20%, pursuant to the agreement between Mr. Carlson and the Attorney.

C. Lack of Transparency and Documentary Support; Lack of a Valid Basis for the Reductions Granted

Ad hoc assessments that do not reflect the fair market value of real property are prohibited by the New Jersey Constitution and state law governing tax assessors and tax assessments. The County Tax Board's denial of the private owner's tax appeal raises concerns about whether Mr. Carlson's grant of 20% reductions to the Developer reflected fair market value. The lack of supporting documentation raises further concerns about the legitimacy and transparency of this tax assessment process.

Mr. Carlson stated to OSC that the reductions granted to the Developer were granted in part because the real estate market had weakened and in part because Mr. Carlson was concerned that the Developer would "go bankrupt," which, according to Mr. Carlson, would have had negative consequences for Edgewater. Mr. Carlson did not receive any documentation from the

Attorney in support of the notion that the Developer faced bankruptcy or demonstrating that there had been a 20% drop in fair market value necessitating the reductions. The Attorney stated to OSC that he had informed Mr. Carlson that the project might fail absent the reduction, but not that the Developer faced bankruptcy.

As confirmed by the Division of Taxation, the financial well-being of a property owner is not a valid basis for a tax assessment reduction. Such reductions should never be granted simply for the financial benefit of a property owner.

V. The Developer's 2009 Tax Assessment Reductions Lacked Transparency and Documentary Support and Were Disproportionately Large Compared to the Reductions Received by Other Condominium Owners

A. The Agreement

Despite their 2008 agreement, the Attorney and Mr. Carlson later renegotiated that agreement to provide for even more generous tax assessment reductions for the Developer's 128 units for the 2009 tax year. (By that time, an additional 9 units had been sold to private owners.) Specifically, the remaining 49 Developer-owned condominium units that had received a 20% tax assessment reduction in 2008 received an additional 45% tax assessment reduction in 2009. These 49 units thus received a total reduction of 56% off of their initial assessed value. The other 79 Developer-owned units received a tax assessment reduction of 45%, except for one unit that received a reduction of 48%.

Mr. Carlson stated to OSC that the Developer's 2009 reductions were negotiated in one telephone call from the Attorney to Mr. Carlson during November 2008. According to Mr. Carlson, during that call Mr. Carlson was performing calculations "in [his] head" to come up with the reductions. Mr. Carlson stated to OSC that in his opinion, the real estate market at that

point had dropped by 25%. Thus, Mr. Carlson reported that he and the Attorney began the negotiations downward from an across-the-board decrease of 25%.

According to Mr. Carlson, these negotiations to lower the assessments a second time were conducted once again in part to assist the Developer because of Mr. Carlson's concern that the Developer would "go bankrupt." Again, Mr. Carlson did not receive any documentation from the Attorney in support of the notion that the Developer faced bankruptcy (a notion that the Attorney denied relaying to Mr. Carlson) or that the development might fail, and Mr. Carlson did not generate any documentation justifying the reductions.

Because the 2009 reductions were granted by Mr. Carlson to the Developer during the assessment period, no tax appeals had to be filed. Rather, Mr. Carlson simply lowered the Developer's assessments before submitting the assessments to the County Tax Board for the 2009 tax year. Tax assessors submit such assessments via an annual "tax list," which lists all of the property in the municipality and the tax assessment for each property.

B. Disparate Treatment of Condominium Owners

In 2009, 31 private condominium owners at the Peninsula appealed their tax assessment. Of these 31 owners, 28 were represented by the same Attorney who represented the Developer. Mr. Carlson represented the municipality in these appeals and negotiated settlements with the Attorney for these 28 units. Yet, not one of the 31 private condominium owners received a tax assessment reduction from negotiations with Mr. Carlson of even half that granted to the Developer. Specifically, one of the 31 private owners received a 20% tax assessment reduction, one received a 5% reduction and the other 29 received 15% reductions. This was despite Mr. Carlson's subsequent assertion to OSC that in his opinion, the real estate market had dropped by

25%. When asked about the discrepancy in the negotiated settlements, the Attorney stated that he negotiated with Mr. Carlson to obtain the best deal he could for each client.

Among these 31 owners was an owner whose unit had received a 20% tax assessment reduction in 2008, when the unit was Developer-owned. While the units that remained Developer-owned received additional reductions of 45% in 2009 (totaling 56% for 2008-2009), this owner appealed his tax assessment but received a reduction of only 15% in 2009 (totaling 32% for 2008-2009), approximately one-third of the 2009 reduction provided to similarly situated Developer-owned units. The condominium owners that did not appeal their tax assessments did not receive any tax assessment reduction.

When asked about these discrepancies, Mr. Carlson stated that he used different assessment methodologies for the Developer as opposed to the other owners. Specifically, he stated that the "income approach" was used for the Developer and the "sales approach" was used for the private owners. Mr. Carlson similarly noted in his response to the draft report that he believed that "case law" permitted him to do this.

Mr. Carlson's interpretation of the law is incorrect. According to the Division of Taxation, when assessing multiple units within a single building, the assessor should evaluate the property using the appraisal principle of "highest and best use" and apply one of the three valuation approaches: cost approach, sales comparison approach, or income approach. The cost approach values each unit based upon the cost to build it. The sales comparison approach compares the subject property with similar, recently sold properties ("comparables") to determine the value of the property. The income approach analyzes the future income stream expected to be produced by the property.

According to the Division of Taxation, the most appropriate valuation approach for a condominium building should be determined and utilized for all of the units in the building. Very rarely, courts have allowed different appraisal approaches to be used for different units in one building, but as the Division of Taxation noted in its response to OSC's draft report, none of those exceptional circumstances were present at City Place.

In addition, Mr. Carlson's explanation about his use of the income approach for Developer-owned units is undermined by the fact that he never was provided with and did not generate any documentation that would have supported use of the income approach. In order to apply the income approach Mr. Carlson would have needed to know detailed information about rents and expenses for these units. He did not, however, report having such data and did not rely upon any written data or analysis. We also note that in 2011 when Edgewater reassessed all property in the municipality using an outside vendor, all Peninsula units were evaluated using the sales approach even though approximately 52 units remained Developer-owned.

In sum, although the Developer and the other owners were similarly situated in 2009 for property tax purposes, the Developer received, on average, more than three times the assessment reductions received by the other owners. All of these units are located in the same development, Mr. Carlson was the same assessor in each instance and the same Attorney who represented the Developer represented and negotiated settlements for 28 of the 31 private owners who appealed their 2009 tax assessments. Yet the private owners received average tax assessment reductions of 14.83%, while the Developer received an average reduction of 49.23%. The Developer simply was treated substantially more favorably by Mr. Carlson than similarly situated private property owners. Moreover, as with the 2008 reductions, the 2009 reductions occurred without Mr. Carlson compiling or maintaining any documentary support that would indicate that the

reductions reflected fair market value for the units. The tax assessment reductions granted to the Developer contravened the New Jersey Constitution's requirement that all property be assessed using the same standard of value and the governing law requiring assessors to determine the fair market value of real property.

C. Example Demonstrating the Disparate Treatment Resulting from the Tax Assessor's Actions

In 2011, the tax assessments of the Peninsula units again were adjusted following a reassessment of all property in the Borough of Edgewater by the Tax Assessor's Office and an outside vendor (the Vendor). Mr. Carlson noted to OSC in his response to the draft report that he had recommended that the reassessment be conducted. Table 1 on the following page demonstrates the disparate treatment of three of the Peninsula condominium units up until that time. The three units originally were assessed at the same value.

- Unit 1209 was sold to a private owner in May 2007. Its owner never appealed the initial tax assessment. Its assessed value remained constant at $426,600 from 2008 through 2010.
- Unit 1309 also was sold to a private owner in May 2007. Its owner appealed the tax assessment in 2009, yet it received a substantially smaller tax assessment reduction via negotiated settlement than the Developer received, resulting in a $362,600 tax assessment.
- Unit 1303 remained Developer-owned through 2010. Its tax assessment was reduced twice and was reduced significantly more than that of private owners who appealed their assessment. The Developer's tax assessment ultimately was reduced to $187,700 in 2010, compared to the $426,600 assessment for Unit 1209 and the $362,600 assessment for Unit 1309.

Table 1

Unit	2008 Original Assessment	2008 Final Assessment	2009 Original Assessment	2009 Final Assessment	2010 Assessment	2011 Assessment
1209 – Privately Owned	$426,600	No Appeal	$426,600	No Appeal	$426,600	$297,700
1309 – Privately Owned	$426,600	No Appeal	$426,600	$362,600	$362,600	$297,700
1303 – Developer Owned	$426,600	$341,300	$187,700	No Appeal	$187,700	$297,700

As noted previously, Mr. Carlson's agreement with the Attorney for the 2009 tax assessment reductions was entered before the annual tax list was filed and the reductions were made by Mr. Carlson without any supporting documentation. The only way to detect the disparate reductions would have been to obtain the tax assessments for multiple years and perform a line item comparison. As a result, these disparate reductions were not detected by the County Tax Board. According to the Division of Taxation, in the last several years there has been a spike in the number of tax appeals and the volume of work before county tax boards. The Division explained that as a result, some county tax boards do not have sufficient staffing to produce and review line item comparison reports for each property in every municipality to detect this type of abuse. But for the complaint filed with OSC by a concerned citizen, the Developer's inequitable tax assessment reductions would have, in all probability, remained undetected.

VI. After the Developer Sold the Condominium Units, the Tax Assessments Were Raised

A. Added Assessments

According to Mr. Carlson, he and the Attorney agreed that after the sale of the condominium units from the Developer to other owners, the tax assessments would be restored to "market value." He told OSC that he would determine that market value by subtracting 10% from the sales price. The Attorney denied that he and Mr. Carlson had such an agreement and stated that Mr. Carlson simply informed him that after the sale of the condominium units to other owners, the tax assessments would be based on the sale prices. In any event, Mr. Carlson reported that consistent with his discussions with the Attorney, the tax assessments for units sold to other owners were brought back to market value in 2010 through the use of "added assessments." The fact that the assessments on these units increased significantly after they were sold further confirms that the adjustments made for the benefit of the Developer had not been reflective of actual value.

An "added assessment" is an increase in a tax assessment that reflects a change in the value of the underlying property, such as a change resulting from an addition to or a renovation of the property. Such added assessments are used when the change occurs after the tax assessment is set on October 1 of the preceding tax year. Mr. Carlson reported that the Vendor handles such added assessments for Edgewater, but that Mr. Carlson oversaw the work of the Vendor. Ultimately, Mr. Carlson, as the municipal tax assessor, was responsible for all of the tax assessments in Edgewater. According to the Division of Taxation, added assessments never should be used to increase property tax assessments based on a transfer of ownership, as happened here. Rather, added assessments ordinarily should be generated only following structural changes. Such changes normally would result in the inspection of the property by the

local assessor. Generally, such work requires a building permit and subsequent inspection by the local construction official.

B. The Tax Assessor Generated Inappropriate Added Assessments for Condominiums Sold to Private Owners

According to Mr. Carlson, he directed the Vendor to generate added assessments in 2010 for all of the Peninsula properties the Developer had sold to other owners. This deviated from the normal process in Edgewater in which the Vendor inspects physical changes to real property, determines the added value and then generates an added assessment. Mr. Carlson informed OSC that in this case he instructed the Vendor to generate added assessments for these units in amounts that would raise the tax assessments to the sales price minus 10%. In total, all 43 condominium units that were sold by the Developer received added assessments after the sale of the unit from the Developer to another owner.

Most of the added assessments, however, initially amounted to significantly more than sales price minus 10%. Mr. Carlson attempted to explain this to OSC by stating that the cause of the error was a computer virus or "bug" in the Vendor's computer system. Mr. Carlson was not able to explain why the virus or "bug" affected only these added assessments and not others generated in Edgewater at that time. The Vendor's president, in an interview with OSC, denied knowledge of any such computer problem or "bug" in the Vendor's system. In his response to the draft report, Mr. Carlson provided the name of an employee of the Vendor who he said would corroborate his version of these events. OSC interviewed this employee, who did not corroborate Mr. Carlson's version of events.

In any event, Mr. Carlson stated that as a result of the incorrect assessments caused by the "bug," Mr. Carlson, on his own initiative, appealed all of these added assessments to the County Tax Board and judgments were issued to correct the errors. It should be noted that the

final assessments still were not sales price minus 10%, as Mr. Carlson claims to have directed. OSC could not discern any justification or pattern for the tax assessments ultimately generated as a result of Mr. Carlson's appeals.

Moreover, these added assessments, as with the Developer's tax assessment reductions in 2008 and 2009, were generated without any documentation or justification demonstrating that the added assessments were appropriate. No other properties that were sold in Edgewater during this time period received added assessments other than the City Place properties that the Developer sold to private owners. In addition, there was a lack of transparency in the process because Mr. Carlson never put his alleged request to the Vendor in writing and the added assessments were generated without any statement concerning their need. The lack of transparency made detection of the inappropriate assessments extremely difficult.

VII. Consequences of the Inequitable Assessments: The Developer Received Tax Savings of $472,521.12

In an effort to quantify the ultimate benefit to the Developer resulting from Mr. Carlson's actions, OSC calculated the total dollar amount of the tax savings received by the Developer.

In 2008, tax assessment reductions on the Developer's 50 condominium units totaled $4,810,900. Multiplying this amount by the tax rate for Edgewater in 2008 reveals that the Developer would have owed an additional $52,583.14 in taxes had it been treated the same as similarly situated private owners.

In 2009, tax assessment reductions on the Developer's 128 condominium units totaled $32,390,800. Applying the 2009 tax rate, the Developer would have owed an additional $243,747.23 in taxes had it been treated like other, similarly situated Peninsula owners, the majority of whom received a 15% reduction.

In 2010, the Developer owned 104 Peninsula condominium units. These units continued to receive the benefit of the 2008 and 2009 tax assessment reductions. The total dollar value of these reductions was $26,470,400. Applying the 2010 tax rate, the Developer would have owed an additional $176,190.75 in taxes had it not been granted the disproportionate reductions.

Therefore, for tax years 2008 through 2010, the Developer received a total tax benefit of $472,521.12.

Governing bodies set tax rates to provide a certain level of revenue for operating expenses, based on the total tax base. If tax assessments on selected properties are reduced, necessary revenue must be obtained from other sources, particularly through an increase in tax rates. As a result, the inequitable assessments granted to the Developer forced other property owners in Edgewater and elsewhere in Bergen County to bear the Developer's reduced tax burden.

VIII. Conclusions

- The Developer received, on average, more than three times the tax assessment reductions granted to other, similarly situated owners in the Peninsula complex.
- The negotiated agreements between Mr. Carlson and the Attorney in 2008 and 2009 were based upon an incorrect rationale, lacked supporting documentation and suffered from a lack of transparency. By negotiating tax assessment reductions without appearances before the County Tax Board and without preparing and maintaining supporting documentation, Mr. Carlson was able to enter into non-transparent agreements that were based on incorrect legal principles without raising concerns at the County Tax Board or the Division of Taxation.

- Added assessments were used in 2010 in an attempt to bring the tax assessments back to market value after the assessments were below market value for the inequitable benefit of the Developer. However, an appropriate methodology was not used and the added assessments still did not reflect market valuation. In engaging in such actions, Mr. Carlson acted outside of the requirements of the New Jersey Constitution and state law. There was no basis in tax policy for Mr. Carlson's actions.
- Mr. Carlson granted tax assessment reductions to the disproportionate financial benefit of a private corporation and to the detriment of other local taxpayers. These tax assessment reductions contravened the New Jersey Constitution and governing state law.

IX. Recommendations

1. In addition to filing tax lists with County Tax Boards each year, tax assessors should be required to file a line item comparison report. This report should include only those tax assessments that have been adjusted by 20% or more from one year to the next. Tax assessors should be required to submit an explanation and justification for these adjustments. County tax administrators, under the supervision of the county tax boards, should spot-audit a subset of these reports prior to finalizing tax assessments for the tax year.
2. The Division of Taxation should develop a methodology to identify multiple properties owned by a single entity that appear materially underassessed relative to other, similarly situated properties. For example, sales and assessment data are captured each fiscal year by the Division of Taxation in a report entitled

"Accumulative Usable Sales," which indicates the ratio of assessment-to-sale price of property sold during the previous fiscal year. This document could be used to identify potential abuses. The properties identified should be referred to the appropriate County Tax Board to determine if the assessments are appropriate.

3. The Division of Taxation should issue regulations requiring tax assessors to memorialize negotiated settlements. These regulations should address, for example, the necessary parameters of memorialized agreements, the required signatories and the length of time and form in which the agreements must be maintained.

4. The Division of Taxation should issue regulations requiring tax assessors to maintain documentation justifying, based upon market value, tax assessment reductions they grant in the course of preparing the annual tax list. These regulations should address, for example, the type of documentation necessary to support tax assessment reductions and the length of time the documentation must be maintained.