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**PUBLIC HEARING**

before

**ASSEMBLY OVERSIGHT COMMITTEE**

**"Motor Vehicle Agency Leases"**

Held:

June 16, 1983

Assembly Majority Conference Room

State House

Trenton, New Jersey

**New Jersey State Library**

**MEMBERS OF COMMITTEE PRESENT:**

Assemblyman William E. Flynn (Chairman)  
Assemblyman Harry A. McEnroe (Vice Chairman)  
Assemblyman Joseph Charles, Jr.  
Assemblyman Anthony S. Marsella  
Assemblyman D. Bennett Mazur  
Assemblyman Edward K. Gill  
Assemblyman John T. Hendrickson, Jr.  
Assemblyman Walter J. Kavanaugh  
Assemblyman Richard A. Zimmer

**ALSO:**

Steven B. Frakt, Senior Research Associate  
Office of Legislative Services  
Aide, Assembly Oversight Committee

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Paul M. Marzell Real Estate Appraiser and Consultant	28
Caesar Iacavone Real Estate Bureau Chief	51
Steven Levitt, Esq.	52

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**ASSEMBLYMAN WILLIAM E. FLYNN (Chairman):** I would like to call the hearing of the Assembly Oversight Committee to order. Today's topic will be the first of a series of hearings concerning State leasing policies and practices focusing not only on the early stages of Motor Vehicle agencies, but other State leasing policies as well, because it is a broad topic.

It also concerns itself with a lot of money as there are millions of dollars involved in this project, so it behooves us to make sure that we are getting the "biggest bang for our bucks," so to speak.

One of the reasons the hearings were generated was because, for the first time as long as I've been in the Legislature, a Speaker turned down the signing of leases. As you know, under the State rules and regulations, all of the officials of the State government have to sign off on the leases, including the Senate President and the Speaker of the House. So, when Speaker Karcher refused to sign certain leases, a controversy occurred, and it is this Committee's job to get to the bottom of the controversy, find out what the facts are, and then make its recommendations.

I deem it appropriate to start off with the Speaker today as our first witness. Speaker Karcher, will you raise your right hand please?

WITNESS BEING DULY SWORN, TESTIFIED AS FOLLOWS:

**ASSEMBLYMAN FLYNN:** Mr. Karcher, perhaps the best way to start is to tell us why you did not sign a number of Motor Vehicle leases.

**ASSEMBLY SPEAKER ALAN F. KARCHER:** Let me start by saying that this is an obligation. The review of these leases is an obligation and certainly a responsibility that I did not seek other than indirectly by becoming Speaker. It is within the statutory framework that this responsibility is imposed upon the heads of the two legislative branches. However, that responsibility having been placed upon me, I have felt and feel now obligated to fulfill that obligation to the best of my ability, and to bring to that process the information and knowledge that I have.

As you know, Mr. Chairman, and I think many others know, I have been a practicing attorney for almost sixteen years. Up until the time I became Speaker, I was actively practicing law, and a very, very substantial portion of the prior practice in which I engaged in in years past was in tax work, particularly municipal assessments. I am the attorney for the municipality of Sayerville, the City of Rahway in Union County. Sayerville, of course, is in Middlesex County. I have been retained as special counsel by a number of other municipalities spread out over a number of counties within the State.

I have handled tax appeals over the course of the last ten years, probably with an aggregate contested evaluation of approximately a billion dollars. I'm not saying that is the amount of tax involved, but that is the amount of contested assessments involved. It is an area in which I have some familiarity.

As leases were presented to me, I, and I shouldn't put it in this frame -- that the State of New Jersey is the largest tenant unquestionably in the State of New Jersey, and it is probably one of the major tenants in the United States. The aggregate of rented property supervised by the State of New Jersey, or under the jurisdiction of the State of New Jersey, is well over seventy million dollars. These are annual rents that we pay -- seventy million dollars.

The amount of leases that came to my attention numbered in the hundreds. I did not think it would be a proper exercise of my jurisdiction or my responsibility to give cursory approval to these.

We examined them. I signed a number of leases previously, using as guidelines what I thought to be reasonable square foot prices. I stopped that process almost nine months ago in September or October of last year when leases began to be presented to me that when measured against my background and my experience, particularly in tax work, just seemed to be totally anomalous, totally at variance from what would be acceptable leases and what was current market rates throughout the State of New Jersey.

Those that seemed to be at variance and were anomalous to the general pattern fell mostly in the area of Motor Vehicle agencies. As a result of my difficulty with these and my inability in good

conscience to sign them, I consulted with my counterpart, Carmen Orechio, the President of the Senate, and arrangements were made to have further discussions with the Office of Legislative Services to set up a standard review procedure so that the Legislative Branch could review these leases and have some advice given to the heads of the Legislative Branch as to whether or not they were within normal guidelines and within standard practice within the State.

We have since that time secured two people on the nonpartisan staff of the Office of Legislative Services who are engaged in this function.

We still have the problem with regard to Motor Vehicle leases, and there are a number of Motor Vehicle leases for Motor Vehicle agencies which I have not signed. The primary reason I have not signed them is that I believe that the State, number one, could do much better, could do much, much better. I think the experience of how much better they could do is proven by the experience in my district in the Township of Woodbridge, and I know, Mr. Flynn, prior to the calling of this session, you had seen the articles in the News Tribune, which is published in Woodbridge Township, about the Motor Vehicle lease in Woodbridge.

That is an interesting lease for a number of reasons, as I pointed out to you. First of all, by speaking to attorneys and real estate people and shopkeepers, just owners of businesses in downtown Woodbridge on Main Street, I found out that the current rate, the going rate for square footage in Woodbridge, New Jersey was approximately \$7.00 to \$8.00 per square foot.

I was being presented with a lease that called for \$18.87 per square foot, or at least 200% of what I knew to be the going rate in the Township of Woodbridge, which, by the way, is also a municipality for which I am special counsel doing certain work involving assessments of property.

As a result of the controversy that arose from that particular lease, I am delighted to discover that Mr. Kachinski, who was the prospective landlord, had agreed voluntarily to lower the lease. In fact, he spoke with me directly on the phone, saying that he would be delighted to sign a lease at \$13.00 or \$14.00 per square foot, or at least 25% lower than what he had originally asked for.

I now discover that he is also willing apparently to give free space on an interim basis to the State of New Jersey. There have been other negotiations apparently to secure more favorable sites with parking space for a much lower price, and I am going to get to that in a moment, Mr. Flynn. So, I think that the controversy has already born fruit and we have already seen that the State, given the challenge of looking for more competitive prices and bargaining a little harder, can do much better.

I would point out another factor that I think is critical. That is the parking. In the Woodbridge situation, and Woodbridge is a lovely community, this particular site had no parking involved with it. It would have been on-street parking with municipal parking in adjacent areas, but no given parking area with it. For the nature of services being rendered at these stations or at these Motor Vehicle agencies, parking is a very important factor.

Of course, from my experience in municipal law, I know that there are certain rules of thumb about the ratio between interior rented space and how many parking spaces must be provided for commercial or professional establishments. I would think that that should be honored in all instances.

I would point out that in some leases no provision is made at all as to what exactly it is that the State is leasing, whether we are leasing just the building, whether we are leasing with certain designated spots also to be leased, or whether we are leasing it with no specific areas whatsoever.

The other part, and I am going to get back to parking in a second, is that I have asked for eight or nine other leases to be renegotiated. That is because the State participates in a program whereby we seek renovation of certain properties in order to comply and to conform with requirements of the State. The State, rather than doing it themselves, has engaged in a practice whereby the State has become a lender, but not a lender or a borrower from normal sources, because the State can secure money, as we know. Even in the worst of times, the State was selling bonds under 10%. Rather, the State has gone to the landlords themselves and made the landlords bankers for the State and is now repaying those quasi bankers who are the landlords the



rate of 18% interest -- 18% interest. That to me is a rather significant thing in three respects.

Number one, it vastly exceeds the price at which the State has access to credit markets, so it is an unwise choice of a credit market.

Number two, it is vastly higher than what the State can secure loans for, or almost anyone can secure a loan for, even in the best of times. Presently, interest rates have dropped severely and drastically, and this is something that I think we are all delighted to see. Why the State should still proceed on a plan to pay 18% interest on renovations strikes me as being absolutely insane at this stage of the game. This was only brought about, by the way, I should suggest to you, because the State wants these renovations done. The State engages in the practice of leasing for five years. The renovations for the most part are standard, and they are renovations that will last and benefit the landlord for a substantial period in excess of those five years. So, what the State is doing is paying for the improvements to the buildings, which the landlord after five years will reap the benefit of. The State is paying for them dollar for dollar, and not only paying for them dollar for dollar, but turning the landlord into the State's banker and paying him 18% interest on top of dollar for dollar restitution for the expenses incurred. I think that is an unwise practice.

I want to conclude by just telling you a few other things. Perhaps the heart of the controversy and the one that really brought this to light was a lease in the Township of Matawan in the Borough of Matawan. It is a lovely community; however, the State of New Jersey pays more on that lease. The reason why, and it really, really struck me, was the fact that I initially thought it was high. It seemed to me from my experience in Monmouth County to be 100% or 200% higher of what my understanding of markets values are in that community.

For the purpose of contrast, we rent space in Washington, DC for the Governor. That space is on North Capitol Street, and it overlooks the Senate lawn. It is a beautiful space, absolutely marvelous. The State of New Jersey pays \$17.50 per square foot in downtown Washington, DC, one of the prime real estate markets in the entire

world. They pay \$17.50 per square foot for office space overlooking the Capitol building and the Senate lawn, and in Matawan, New Jersey we are asked to pay \$19.61 per square foot.

Let me just point out to you a few of the things that I specifically think you would want to get into with regard to that specific lease. In that specific lease, we have a concrete building that was built, according to the tax records, in 1967 at a construction cost of \$10,000 or less. That building today yields a gross rental to the landlord of approximately \$25,493 a year for a building that this landlord erected for \$10,000. It is a building upon which we negotiated, and the records indicated that the State of New Jersey and its employees had serious reservations about the excessive costs for renovation. Those costs were challenged, yet the State of New Jersey paid dollar for dollar what they said was excessive. In fact, they paid \$50 more than what they considered to be excessive.

What we did in that instance was to pay for such traditional and standard things as painting and masonry work on the building itself, which will be there long after, probably fifty years after the State's lease has expired. Those are just some of the troublesome aspects.

We are guaranteed ample parking, but no provision is made for it. I would suggest to you that the justification that was attempted to be given was, with all do respect to the person who participated in it, specious at best. Once again, Mr. Flynn, from my experience in municipal law, the standard rule of thumb for a parking space in the State of New Jersey for zoning purposes and for planning purposes is 320 square feet. I can show you how that works out.

If we were to actually claim that we were renting what they say and try to justify it, we would have parking for 250 to 300 cars. Actually, we have parking for eighteen cars, which have designated spaces. Taking that into account and assuming the land value for that, what we have rented here is a concrete block building, 1300 square feet, apparently parking or perhaps parking -- it is certainly not spelled out-- Perhaps parking for that building, and we are paying \$25,493 per year for the benefit of having that facility.



I want to make it clear that I am not opposed to the facility. I think the idea of looking at a catchment area, looking a service area, and trying to locate within that area is a decision that must be made by those people who are servicing it. But, within that catchment area, we have to be competitive. We should apply to the State the same standards that are functional and operational in the private world.

While I am on that subject, let me just touch upon the fact that all of these leases are negotiated in a vacuum with regard to the tax consequences. Once we let the landlord renovate, the landlord realizes the benefit of the Federal investment tax credit, he realizes the tax benefit under the Federal code of expensing certain items, and he realizes the benefit under the Federal tax code of depreciation on all of those renovations. We operate a total vacuum with regard to those tax benefits. Whatever the yield is to the landlord, and that can be debated as this one in Matawan in my judgment from my analysis was-- That actual yield to this landlord is approximately a 30% return on equity, and that is sheltered.

When I say tax sheltered, I mean that he receives the tax benefits, so when he gets the tax benefits from the investment tax credit, from depreciation and from expensing certain items, he is making what has to be considered a phenomenal, if not unconscionable, profit at the expense of the taxpayers of the State of New Jersey.

Lastly, let me conclude by telling you that I was requested after the discussion within the Appropriations Committee as to what would be done and what I would suggest as to the guidelines that the State should use. Rather than assume or presume that responsibility myself, and I certainly did not want to set myself up as any expert in this field, I secured the advice and counsel of a number of people. Those people will be available, and some of them are available to you today, Mr. Flynn and members of the Committee. But, I have secured advice from those who are in the field of tax indication, in the renting of commercial real estate, and in the formation of syndicates to buy and sell real estate for the tax credits that are involved, etc., so that they can explain to you what these taxes credits that I am talking about really are. They will talk to you about the function of

the 18% interest that the State is paying out when the State can borrow money at half that. We have turned the landlords into bankers by paying them that kind of money.

I have secured the advice of commercial real estate appraisers to make an assessment of the individual lease in Matawan, but more importantly for your purposes, to set out guidelines as to what is applicable and what are the procedures followed in the real world of commercial real estate, not the Alice in Wonderland of giving money away as the State of New Jersey has been doing. They are available to you.

Last, but not least, I have secured advice and counsel from members of academia who teach business law courses, who teach commercial real estate, and who teach tax syndication, etc., and they ultimately will be available to you at later hearings if you wish. Two of those people are scheduled to speak today. I have brought them here so that you might question them to seek their advice and counsel. One is Paul Marzell who has an extensive background in commercial real estate. He has probably as broad an experience in the appraisal and assessment of commercial real property as anyone in the entire State of New Jersey. Also here is Mr. Steve Levitt who is a practicing attorney and a certified public accountant practicing with one of the largest firms in the State. In fact, the Attorney General was a member of the firm a few years ago. Mr. Levitt will talk to you about the tax consequences if you so wish. Both have prepared reports, and I have not asked them to hone in or to focus in on one specific lease, but to talk to you in theory and practice of what goes on in the real world so that you may hopefully render a report with some suggestions-- Not only an analysis of what has gone on in the past, but to really serve the legislative function, the legislative purpose of this Committee, and that is to give guidance, counsel, observation, and suggestions as to what should be done in the future.

With that, I thank you for the opportunity--

ASSEMBLYMAN FLYNN: Are they here now, Mr. Karcher?

ASSEMBLYMAN KARCHER: Mr. Marzell is here. I don't see Mr. Levitt yet, but-- Oh, Mr. Levitt is here. He was here for those kind words I said about him.

With that, if you have any questions, Mr. Flynn, I would be glad to answer them for you.

ASSEMBLYMAN FLYNN: Does anyone on the Committee have any questions?

ASSEMBLYMAN HENDRICKSON: I have just one. I commend you, Speaker, for the protection you are telling us about with regard to the monies of the great State of New Jersey.

I heard you expound on leases and bankers and percentage rates, but I haven't heard anything on the vacancy rate in the area of Matawan regarding office space or commercial type buildings that would have the accessibility for the public, which evidently this one has. Do you have anything on the vacancy rate in that area?

ASSEMBLYMAN KARCHER: The vacancy rate in that area, for instance-- There is a building that is now available on the very same street, if I'm not mistaken, which is brand new. It has all the accouterments, plus, which would be available at a rate substantially below this rate. I have not sought this out, although we have done a general cursory study of the availability of space.

The way the Motor Vehicle agency does it, John, is not to talk about a specific town; they talk about catchment areas. When you talk about a catchment area, you're talking about something with say a radius of ten, twelve or fifteen miles. When you draw that line and that circle, I'm certain -- in fact, I know -- all you have to do is drive through it. If you would like to come down and drive through that particular catchment area with me, you'll find literally dozens of potential sites.

ASSEMBLYMAN FLYNN: I would like to add to that. After this controversy came up, I personally toured up and down Routes 34, 35 and 36 in that catchment area, which was Matawan, Aberdeen, and Hazlet. I saw and noted at least fifteen different spots for rent which were of similar type construction. They were about the same size with the same extendabilities, so in answer to your question, I believe there are ultimate sites in that one area.

ASSEMBLYMAN KARCHER: I want to emphasize strongly, John, that I am very much in favor, and Mr. Flynn has written to me about it. Mr. Van Wagner, who is a representative from that area, has written to me saying that they needed it. I agree. There would be nothing better than to have a Motor Vehicle agency there.

The next question is, if you are going to have it there, what are you going to pay? Don't you want to pay a fair price? That is my only point, John. If we are going to have it there, we should pay a fair price. We should not give the State's money away.

ASSEMBLYMAN FLYNN: Are there any other questions?

ASSEMBLYMAN HENDRICKSON: I have no problem with that, Mr. Speaker, but at the same time, in leasing property, there are gross rent multipliers' return on their money. Different areas are going to produce different kinds of return either of necessity or one way or the other. I don't take too much credence in a new building now coming on lease to attract something of the value or of the foot traffic that an agency would produce.

There are leases at times that will be put out to attract -- what they call an anchor lease -- to create traffic for that new building.

ASSEMBLYMAN KARCHER: I understand that very well. John, in regard to that, let's take this lease. I don't want to monopolize this conversation, but let me just go through it very quickly. From my point of view as an attorney and from the kind of work that I have done in tax appeals, you have a building here-- And, by the way, one of the things that I think you would want to look at is that this particular building, at the same time, at the very, very same time that they were negotiating a lease, and the real estate agent who was negotiating it was negotiating for \$25,493 a year-- At that very same time, the landlord had filed a tax appeal with the tax board of Monmouth County saying that the land was overassessed. The very same real estate broker who was negotiating this lease for that landlord with the State submitted an appraisal of this land. He had been the former tenant, and nobody questioned that. They didn't even bother to ask him what he paid. Nobody bothered to ask what he paid as the former tenant. That same landlord had filed an appraisal to support a tax appeal, saying it was overassessed and should be lowered.

I don't think anybody will disagree that for this 1300 square foot concrete block building the very, very best price-- You and I could go out and build it today and replicate it for \$45,000 or \$50,000. Okay? Now, if you take parking, even if you took forty spaces, which is more than enough for anybody, you would have 12,000 or 13,000 square feet. That is a quarter of an acre. So, you have a 1300 square foot building, and what you have rented is the right to park on about a quarter of an acre. Take that price and say the land is worth anything, but what you really have to do is to determine what the State has leased. It hasn't leased anything but the building, so I say that we should put in the parking as well.

What you have is a package of land and real estate that the State is renting, which is approximately worth at the maximum \$65,000 or \$70,000 -- maybe \$80,000, if you want to be generous. So, for something that is worth \$80,000 on the market, we're giving \$25,000 a year in rent. If you want to chop that down and just talk about the base rate, you're still talking about \$15,000 or \$16,000 per year in base rent, which is an astronomical yield on the investment. But, more importantly, it is a tax shelter on the investment. That is just not right.

John, when I see real estate all over the State of New Jersey -- and you can pick up your paper or the Bergen Record or the Star Ledger on Monday and you can see what real estate is selling for or what it is renting for. You can see in the most prime area of the State where prices are being quoted at \$10, \$11, or \$12 per square foot in places that we all know have a higher real estate market than that one. How in the world can you justify \$19.61 in Matawan, New Jersey, when the most prime, the most exclusive areas of the State are advertised weekly in those newspapers at one-third lower than that? That is all.

ASSEMBLYMAN FLYNN: Mr. Zimmer, and then Mr. Kavanaugh.

ASSEMBLYMAN ZIMMER: Mr. Karcher, I have some familiarity with real estate leasing, too. I am an attorney with a large corporation, and I review the leases on a weekly basis.

I would like to know whether you think that these rentals that you are comparing the State rentals to are net leases or what I

think could only be called gross leases, which are the State leases-- That is, do these rentals of \$10, \$11, an \$12 per square foot include tax escalation, operating cost escalation, heat, and utilities?

ASSEMBLYMAN KARCHER: There is a very interesting phenonemon with this lease, Mr. Zimmer, as to what is gross. The real estate taxes, which included the building itself in Matawan, would come to around something like \$1100 per year, if I'm not mistaken; they were included in the base rate. But, they have included in the lease, and you will see it in the document that has been prepared, a tax escalation clause. So, as taxes go up, this will go up as well. But, the taxes in this one were handled differently. They were incorporated into the \$12.00 or the \$12.50 base rate.

When you take 1300 square feet, what we are paying actually is about \$2.00 per square foot for taxes, where the taxes on this building, the concrete building itself, were less than \$1.00 per square foot. The prices I'm quoting are gross rentals.

We have situations, for instance, in law firms that we have talked to, where they are renting space in brand new buildings -- places like Roseland, Livingston, and Cherry Hill -- where the gross rental is coming in at \$13 or \$14 per square foot. These are absolutely brand new buildings.

I don't know, maybe I should ask you. Does your company rent anything where there is a gross price of \$19.61 per square foot?

ASSEMBLYMAN ZIMMER: Frankly, the business people negotiate the base rental, and it is customary in the industry for business offices and warehouse space and virtually any other kind of commercial space to go with the net rental policies. This was especially so in years past when we had such inflation; a landlord couldn't afford to take the risk of a fixed rental. I, as an attorney, have never even bothered to add up all the numbers.

I'll tell you this though: If the landlord agreed to absorb all these costs, not just at the outset, but for the five-year period of escalation, we would be delighted to pay a much higher base rate.

ASSEMBLYMAN KARCHER: I think you will find in looking over the document, that added to the standard lease of the State, we have two things that would have been incorporated, for instance, in the



Matawan lease, those being a tax escalation clause and an operating cost escalation clause. So, by next year, the cost of this building might be more than \$20.00 per square foot. By the end of the five-year term, it might be \$22.00, \$23.00, or \$24.00 per square foot if those escalation clauses were to be added. They were not even given to me. I had to go out and examine and investigate to find out that that was standard procedure in the State leases.

ASSEMBLYMAN ZIMMER: Have you investigated the comparable leases that you say are available at much cheaper rents in Matawan, for instance?

ASSEMBLYMAN KARCHER: No, I haven't gone down and looked at anything specifically in Matawan. I think Mr. Flynn is the person who said that, but I've been advised of one or two.

ASSEMBLYMAN ZIMMER: Have you or your office found cheaper rentals on the same terms when you rejected leases as being too expensive in comparison to other real estate in the area?

ASSEMBLYMAN KARCHER: As I said, regarding the one in Woodbridge, I went out and talked to every attorney that I knew there, I talked to some of the merchants, the tax assessor, and everybody I could. The initial price of one was \$18.87, as I said in my introductory--

ASSEMBLYMAN ZIMMER: Is that net or gross?

ASSEMBLYMAN KARCHER: That was gross. We talked about the State having a need for a special building for air conditioning. I talked to the A&P on that same street. That would have been very comparable because they have massive requirements for air conditioning and heavy wiring because of all the refrigeration. Their gross price is \$7.50, and that was just negotiated this year. They are paying \$7.50 within spitting distance of the lease that was going to go for \$18.87, and they have massive air conditioning and massive refrigeration requirements.

ASSEMBLYMAN FLYNN: Mr. Kavanaugh?

ASSEMBLYMAN KAVANAUGH: Yes, just to change the town for a moment-- On the list of leases, you have Bridgeton.

ASSEMBLYMAN KARCHER: Yes.

ASSEMBLYMAN KAVANAUGH: Can you tell me what your intentions are with the Bridgeton lease and the reason that hasn't been signed?

ASSEMBLYMAN KARCHER: The Bridgeton lease, as I understand, has only one difficulty that has to be checked out, and that is, the extent of the renovations that have taken place there and whether or not any negotiations have taken place with regard to what I just talked about -- the sheltering of the tax benefits. I think on the Bridgeton lease, and I don't have it in front of me, Walter, but--

ASSEMBLYMAN FLYNN: \$48,000.

ASSEMBLYMAN KARCHER: Yes, there are \$48,000 worth of renovations. I wanted to find out if there were competitive bids and how they were checked out.

The other thing that I should mention with regard to this, Walter, and I am sure you know as a contractor-- For instance, the State says that the renovations and estimates are all right, but they never check to find out whether or not those actual dollars are paid. They don't ask for any receipts and they don't ask for any invoices. They don't even ask for any affidavits of services. They don't ask for anything. They just come back sometime later on, see that it was done and say, "Oh, yea."

In other words, I, as a landlord can say I am going to put in a new air conditioner, and it is going to cost \$10,000. I can go out and get my brother-in-law to do it for \$5,000 and I get the other \$5,000. I not only get the \$5,000, but I get the other \$5,000 at 18% interest. There is something strange with that, isn't there, Walter?

Now, on the Bridgeton lease though--

ASSEMBLYMAN KAVANAUGH: That would be called fraud, but I think it is a situation--

ASSEMBLYMAN KARCHER: No, no, no, that is not considered fraud here. That is not considered fraud.

ASSEMBLYMAN KAVANAUGH: If you certify--

ASSEMBLYMAN KARCHER: It might be a sharp practice.

ASSEMBLYMAN KAVANAUGH: If you certify in a contract that you are going to pay "x" number of dollars, and it is agreed to by the State--

ASSEMBLYMAN KARCHER: There is no requirement to certify; you don't certify to that.

ASSEMBLYMAN KAVANAUGH: Well, it should be, but if the State has agreed, and if it is to the benefit-- Certainly this is probably the way that general contractors make their money. They go out and get subcontractors. After they get the bid, they go and push them down and whatever they make is profit.

The concern I have with this, you know, you're talking \$7.55 a square foot, plus the \$48,000, and that is at 10%.

ASSEMBLYMAN KARCHER: 10%. I like the 10%; I think the 10% is very good. The only thing I asked about Bridgeton was the verification of the renovations.

ASSEMBLYMAN KAVANAUGH: Do you have any idea when that will be signed by you?

ASSEMBLYMAN KARCHER: As soon as there is some justification of the renovations, Walter.

ASSEMBLYMAN KAVANAUGH: Have you been in contact with--

ASSEMBLYMAN KARCHER: I certainly think that the Bridgeton lease at the 10% amortization -- not that I agree with the amortization at all, but 10% is certainly something that should be standard as opposed to 18%. We would make great progress with signing these if we could renegotiate that amortization at prime, or 1% over prime.

ASSEMBLYMAN KAVANAUGH: What would have happened if it hadn't been the wisdom of Washington to get the interest rates down from 18%? What would have happened if this lease, for example, in Matawan-- At the time it was 1982, there was an 18% agreement, which was the going rate-- What would have happened if the interest rates had reversed and had gone up to 21% or 22% as they had been in the past? Then, would we have asked these people to renegotiate so there would be the difference? You know, we can't have it both ways.

ASSEMBLYMAN KARCHER: There are certainly two ways, Walter, to hedge against that. In the Matawan lease, for instance, there was one improvement for \$5600 that the State paid cash for; therefore, they did not pay any interest on it. The cost of money to the State in 1982 was approximately 9% to 10%, so you can say that because of the \$5600 that they put up front, they saved at least half of the interest rate on it -- half of the money on the interest rate alone. I give you that as an example.

Before I continue with that counter, let me go back to two other things. You can put in a float, which would be a normal thing -- a floating interest rate as to the cost of money. As part of one of the exhibits, I have here the June 21 "Federal Reserve Statistical Release of Selected Interest Rates." There was nothing approximated at 18% in June of 1982. The sheet is here for you, and you'll get a copy of this later. But, there is nothing approximated at 18%.

Certainly, in today's world, nothing does. If, God forbid, the interest rates go back up, the best way to protect ourselves is to take it at prime or a point over prime or a point and one-half over prime. That is reasonable. But, 18%, even if it were reasonable in June of 1982, which it was not, or October of 1982 when I first got the lease, which it was not, is certainly not reasonable today.

ASSEMBLYMAN KAVANAUGH: All right. But, the concern that I have is that, you know, I wouldn't call it sudden interest on your part, but the interest that you've expressed that "this has been around for years" -- and I think some of the points you are making should be taken and reviewed, and we should make these changes. But, we also have to look at the convenience and the things that are happening for the people who we serve.

ASSEMBLYMAN KARCHER: I agree with you.

ASSEMBLYMAN KAVANAUGH: I'm just wondering if you could tell me the difference when we are talking about space cost, per square foot cost. How do we differentiate between legislative office space and Motor Vehicle office space per square foot cost?

ASSEMBLYMAN KARCHER: I think one of the people who is here and who has advised me can tell you about the difference between office space and commercial retail space and what the amenities are that are standard in those and what is expected with regard to the superior amenities in office space as opposed--

ASSEMBLYMAN KAVANAUGH: Wouldn't you think office space would be more expensive, when you're talking about Motor Vehicle space, than legislative office space?

ASSEMBLYMAN KARCHER: Expecting the amenities that are normally in office spaces, they are normally higher.

ASSEMBLYMAN KAVANAUGH: All right, now I understand in Matawan -- the building in Matawan was the place that was gutted. In talking to other realtors in that area, they said that \$12.00 per square foot is a reasonable cost. If we put it in place and see that we have a \$12.00 base cost, and then we have the additional \$5.11 per square foot for the handicapped in barrier-free facilities--

ASSEMBLYMAN KARCHER: There is nothing there for barrier-free, only the fire door, if I'm not mistaken, in the toilet. There is only one toilet in this building, by the way, and the public doesn't have access to it. Only the employees have access to it.

ASSEMBLYMAN KAVANAUGH: If the building was put back to its original condition or it was set up for something other than a Motor Vehicle agency, which is an open barrier-free area where you just have your counter working with your computers, there is going to be additional cost to the owner. So, I can understand that--

ASSEMBLYMAN KARCHER: If he puts it back to the way it was, it would have been a higher use as office space because it was carpeted and panelled.

ASSEMBLYMAN KAVANAUGH: Right, so, it will cost him some dollars there.

ASSEMBLYMAN KARCHER: Oh, sure. That is a very critical point. The State has required this, and I'm not contesting that the State has required this to be done. What the State has done is, it has taken a building that was office space and asked that it be gutted, so that the carpets would be pulled out, and we paid for that. We paid for the gutting of that building, and 18% interest on top of that. So, we are not paying for an improvement.

ASSEMBLYMAN KAVANAUGH: How much money did we pay to gut the building?

ASSEMBLYMAN KARCHER: The masonry and carpentry costs were about \$8,000. I don't know which was which. There is no breakdown on it either, Walt. There are no invoices and there are no receipts, so we really can't tell.

ASSEMBLYMAN KAVANAUGH: All right, I think that they are areas that should be reviewed. The other thing is, are you at all aware of what the projections are by Motor Vehicle on the items per day that were going to be done on this building?

ASSEMBLYMAN KARCHER: I would imagine they would be standard. They range. For instance, I think Mr. Flynn has a sheet.

And, by the way, in talking about comparisons that used to be done, I have not been able to get a figure, a gross figure, as to what the new Motor Vehicle agency's cost is as opposed to the old one.

For instance, Howell Township, which is Route 9, is like Route 34, which by the way, is in Monmouth County as well and is within an eleven mile radius of this particular location. Route 9 is a two-lane highway as is Route 34 in Matawan. The Howell Township lease comes in at \$6.00 per square foot, or less than \$6.00 per square foot.

You must understand why I have problems with knowing that Howell Township and Matawan Borough are within a fifteen minute drive of each other, both are on major highways, and we pay \$6.00 in Howell.

ASSEMBLYMAN KAVANAUGH: But, you have been to this building. You've seen the building.

ASSEMBLYMAN KARCHER: I've seen the building. It is a concrete block building, Walter.

ASSEMBLYMAN KAVANAUGH: But, you've seen the convenience of the building, the location.

ASSEMBLYMAN KARCHER: I would hesitate to use the word "convenience."

ASSEMBLYMAN KAVANAUGH: I would say that if you were sitting here as an attorney rather than a legislator or the Speaker, that you would say as a businessman, it is an outstanding facility for a location Motor Vehicle agency.

ASSEMBLYMAN KARCHER: I would not say that at all, Walter.

ASSEMBLYMAN KAVANAUGH: Well, then I would be somewhat distressed.

ASSEMBLYMAN KARCHER: The only real access to it is off Broad Street.

ASSEMBLYMAN KAVANAUGH: Yes, but the only thing is, I went down there and went into those lines and talked to those people and said, "What do you think of this facility?" They said, "It is outstanding."

There was person there who had a big load of cards, and I



asked him what he did, and he said he was an automobile dealer in, I think, Linden. Now, I don't know how far Linden is from Matawan. Do you have any idea?

ASSEMBLYMAN KARCHER: Twenty minutes or twenty-five minutes down Route 9 to Route 34.

ASSEMBLYMAN KAVANAUGH: It seemed to me that it was a distance. And I said, "Why did you come here?" And he said, "Because this is an outstanding place. You're in and out of here in ten minutes."

ASSEMBLYMAN KARCHER: Ten minutes. So then, his car would have been parked in the parking space for about ten minutes.

ASSEMBLYMAN KAVANAUGH: And, he was moving through. He said, "This is outstanding." This may have been just the word itself, but regarding the items there, they are doing 50% more according to Motor Vehicle figures, than estimated.

ASSEMBLYMAN KARCHER: Walter, I'm not disagreeing with you.

ASSEMBLYMAN KAVANAUGH: The convenience to the people-- If you talk to both sides, I mean, it's a democratically-controlled area, and they are very pleased.

ASSEMBLYMAN FLYNN: Walter, I've got to correct you on that. It is not a democratically-controlled area.

ASSEMBLYMAN KAVANAUGH: Well, the mayor there-- What is the mayor?

ASSEMBLYMAN FLYNN: The mayor is a Republican.

ASSEMBLYMAN KAVANAUGH: And what is the owner?

ASSEMBLYMAN KARCHER: Well, I'm not disagreeing with you.

ASSEMBLYMAN FLYNN: I don't know what the mayor is, but that is irrelevant.

ASSEMBLYMAN HENDRICKSON: Well, I object to that.

ASSEMBLYMAN KARCHER: Whether this is ideal or not ideal is not really the question. The question is, are we paying a fair price for what we have? If it were the most ideal spot in the world, or the most ideal location in the world, does that mean you should pay at least 30%, 40%, 50%, or even 100% more than what the actual fair rental value of it is? That is the only disagreement you and I have. We might disagree that on a scale from one to ten as to whether it is a

ten or a five or a three, but Matawan is a good location for it, as would be Aberdeen Township, or almost anyplace, even Marlboro Township. Anyplace in that catchment area would be ideal if it had highway access and sufficient accessibility.

The question is, Howell Township is on Route 9 and pays \$6.00 per square foot -- \$5.91 per square foot, so why should we pay \$19.61 for this? Walter, this is the highest priced lease, and you represent a very wealthy area, don't you? Medium income -- you won't deny that, will you, Walter?

ASSEMBLYMAN KAVANAUGH: Low to middle income.

ASSEMBLYMAN KARCHER: Low -- oh, yes, to middle income.

AUDIENCE: (Laughter)

ASSEMBLYMAN KARCHER: This is the highest priced lease in the entire State of New Jersey out of \$73 million dollars per year. This is the highest priced lease in the State of New Jersey that the State rents. You can take Newark, Jersey City, Springfield, Summit, Rumson, Far Hills, or wherever you represent. You don't have it, Walter.

All I am saying is, pay if you want a nice site, but pay a fair price for it. Don't be cheated. Don't give the State's money away. That is what has happened here; we've given the State's money away.

ASSEMBLYMAN FLYNN: One thing, Mr. Karcher, and I'll probably ask this of the Director of Motor Vehicles, but I noticed in driving by the site the other day in Matawan that they have now barricaded the Route 34 access. Have you heard anything?

ASSEMBLYMAN KARCHER: Yes, that is true. Yes, they have. They have barricaded it. That is because people who were coming south-bound from Linden were trying to make a left-hand turn into a very narrow driveway, so now they have to turn at the light and go into Broad Street. Before you get to the lumberyard, you turn right and come in the back.

ASSEMBLYMAN FLYNN: I call on Mr. Gill.

ASSEMBLYMAN GILL: Speaker Karcher, first of all, I might say that speaking for the people of Linden, I think it is a lovely town. I'm sorry to see that we're driving them to Matawan.

I would like to ask three broader questions. I have the list here of the forty-six Motor Vehicle agencies. Which of these have you approved since January 1 of 1982? I know which eleven you haven't.

ASSEMBLYMAN KARCHER: I think all but eight or nine of them, but I don't have the list in front of me.

ASSEMBLYMAN GILL: All right. I like what you're saying, Speaker, about the guidelines. I think it is an excellent idea. Are you going to leave the development of the guidelines up to a nonpartisan committee?

ASSEMBLYMAN KARCHER: I'm going to leave that up to-- I think I have done my best to secure advice for you, and as I said, I've secured that advice from commercial real estate appraisers, from tax lawyers, from C.P.A.'s, and from academics. They will all be giving you their suggestions.

I have also, by the way, contacted Mr. Biederman who is as disturbed as I am by what has happened here. I agree with him that we should agree upon an independant third party, a neutral party, to develop guidelines. You'll have to hear from Mr. Biederman as to whether he wants to pursue that course.

But, if we're really talking about management and efficiency in government, this is an area that cries out for attention.

ASSEMBLYMAN GILL: Do you know what the criteria or the guidelines were that were used by the previous Speakers for either approving or rejecting leases?

ASSEMBLYMAN KARCHER: I have no idea.

ASSEMBLYMAN GILL: Do you feel that possibly the guideline, which I think is a good management approach, should have been used by the previous Speakers and by the Department of Motor Vehicles?

ASSEMBLYMAN KARCHER: What I have tried to do is to create guidelines with the Office of Legislative Services. There are things that stick out, and the basic one is price per square foot. Anything that comes above \$10.00 a square foot really deserves a second look. Anything that comes above \$16.00 a square foot deserves a second, third, and fourth look. Anything that comes above \$18.00 a square foot deserves a fifth, sixth, and seventh look. That is the kind of guy I am. I mean, if you ask me what my rule of thumb is, that is what my rule of thumb is all about.

ASSEMBLYMAN GILL: And, that is pretty much the guideline you have been using to--

ASSEMBLYMAN KARCHER: That is the guideline I have been using.

ASSEMBLYMAN GILL: I have one last question, and again, on a broad scale, are you convinced of the need for renovations at the various Motor Vehicle agencies?

ASSEMBLYMAN KARCHER: Let me say this from my experience in the real world rather than the government world. When you go to lease a building, there are certain things that you expect to be there. If I'm a commercial tenant, and if I am going to sell shoes, or if I'm going to sell jeans or insurance, and I come in to rent the building, I'm not even going to look at a building that doesn't have proper wiring, proper air conditioning, proper painting, proper doors, or proper lighting. That is all given.

But, when Walt talks about a \$12.00 a foot base rate, yes, \$12.00 a foot base rate in Matawan might be proper if all the renovations were already absorbed by the landlord.

ASSEMBLYMAN GILL: I think we're talking here about renovations that are due to the EDP, which I know happen to be very special and very expensive.

ASSEMBLYMAN KARCHER: In this case, the only one that I see is a barrier-free access to a toilet for employees. Employees use that toilet; it is not a public toilet. There is only one. There are no mens' and womens' rooms. There is only one toilet for the employees, and that was the only thing that had to do with barrier-free access.

The other thing had to do with a panic bar on the back door.

If I were selling shoes, by the same token, I would want a fire extinguisher in the building I rented, and I would want a fire door, and I would want a panic bar if I'm open to the public.

ASSEMBLYMAN GILL: We're talking about a panic bar and barrier-free, but what I'm referring to -- I quite agree with you, and under normal conditions in renting or leasing, you would expect the wiring to be just so. Would you expect the wiring and all necessary renovations be in for electronic data processing computers?

ASSEMBLYMAN KARCHER: Sure. If were opening up for insurance--

ASSEMBLYMAN GILL: I can't agree with you, Speaker.

ASSEMBLYMAN KARCHER: Well, there is very little difference in a computer terminal, in a cash register, or anything. Most people now in commercial outlets have computers or computer terminals for inventory control, etc., etc., etc.. There is no extraordinary need for wiring.

In talking to the contractors, that building is over air conditioned and over wired with no real need for it in a 1300 square foot area.

For instance, let me give you an example. In Matawan they bricked up the front of the building. They took out windows and bricked up the front of the building. That does two things; really you have a double hit. It lowers your heating cost and electrical cost and it cools because of the fact that you're bricked up, rather than having open windows which would be subject to thermal heat coming in. That is really a double hit then. You get massive air conditioning, you allegedly get massive wiring, and you get it bricked up, so you are really pressed down in overflowing in those instances.

Let me just say this. Let me give you an example from residential real estate. Can you imagine going into an apartment complex, renting and not having light bulbs in the place, or not having paint? If there is one thing that is traditional and standard, it is that when you rent a building, you get a paint job. When you're a new tenant, that is thrown in. It is gratis. You don't expect to rent a non-painted building. Even if you are renting a studio apartment, when you get it, they have done a paint job in there. That is as traditional and as classic as anything in the world.

In this instance, we paid \$1650 for a paint job, and we didn't even know what it cost. Here is my problem, Ed. They quoted \$1650 for paint. Now, you figure out what the interior walls of a building is, which is 1300 square feet. Just take the inside perimeter. That is one hell of a lot of paint -- \$1650 worth of paint and labor for the inside of a building. The inside of that building isn't much bigger than this room. It truly isn't much bigger than the inside of this room. It may only be 20% or 30% bigger than the inside of this room. Can you imagine \$1650 to paint the inside of this room? Can you imagine?

ASSEMBLYMAN KAVANAUGH: If your brother-in-law did it.

ASSEMBLYMAN KARCHER: Yes, if your brother-in-law did it, Walter, yes, you could pay \$1650.

And then on top of the \$1650, we pay 18% interest.

ASSEMBLYMAN GILL: I guess what I want to stay with, and it has been my experience in repairing buildings for heavy-duty computers that require particular amperage, 200 amps--

ASSEMBLYMAN KARCHER: Yes.

ASSEMBLYMAN GILL: (continuing) special air conditioning that you don't see anywhere else, and I guess all I'm trying to figure out is this. In the cost of your developing, you are undoubtedly going to have quite an input into developing the criteria. You should. Have you taken into consideration the special requirements for computer work? That has nothing to do with painting, brother-in-law, or not.

ASSEMBLYMAN KARCHER: I think there are other people who can tell you more about what the computers of today are. You know, they are terminals; they don't generate an awful lot of heat. The air conditioning is more than adequate there. I think Walter might be able to tell you.

We have pictures to show you, too, what is actually in the building. It is not like Univac; there is no Sperry Univac there. There are a couple of little terminals.

Is there anything else?

ASSEMBLYMAN FLYNN: Mr. Karcher, in the packet that we have, there is a letter from R. L. Tourlini who is the Assistant Director of Licensing and Registration to Mr. Caesar Iacavone, the Chief of the Bureau of Real Estate, the subject being the Matawan site. It indicates that he believed the building required minor renovations.

Somewhere else in the packet, I noticed that a question was raised as to the cost.

ASSEMBLYMAN KARCHER: If I can comment on that, we have a building that we know we could replace. We know we can build from the ground up for somewhere between \$35,000 and \$45,000. When you talk about the minor renovations being \$29,000, \$29,000 against a \$45,000 construction cost, it isn't minor in my book.

ASSEMBLYMAN FLYNN: All right.



ASSEMBLYMAN KARCHER: I don't know how you measure minor, but minor, when you talk about 80% of the value of the existing building, that is not minor.

ASSEMBLYMAN FLYNN: Also, in the file, there seems to be some indication that the State itself thought that the cost estimates were high. Do you have any background on that for us?

ASSEMBLYMAN KARCHER: Not only do I have background on that, but let me point out the materials that I can present to you. The State met with them and they got this estimate that they thought was excessive. They asterisked five items they thought were excessive. They sent it not only to the real estate agent, but they also sent it to Senator Gallagher, Senator Gallagher's aide. Now, why they did that, I have no idea. I have no idea why Senator Gallagher's aide would get a copy of the items they considered to be excessive, although you'll see in the memos that apparently when the items of excessive cost came up, Senator Gallagher took a distinct interest in that problem.

But, after these items were asterisked as being excessive, the State ultimately paid for them dollar for dollar even though they thought they were excessive, plus \$50 on top of that. They did that after sending a copy to Senator Gallagher's aide for his comments or his participation or whatever he did, and I don't know what he did. I don't know why Senator Gallagher's office would be concerned in the State saying that something was excessive. I would think that they would want to see that the State got a fair rental and paid a fair rental as well.

But, the State wound up paying what they deemed to be excessive, plus \$50 more. They also never got a receipt or an invoice for any of the work to see that it was actually done or paid for.

ASSEMBLYMAN ZIMMER: Will Senator Gallagher have an opportunity to respond to that before this session is over?

ASSEMBLYMAN FLYNN: Well, we are solidly booked today, but we're going to have two or three hearings on this, so he'll have ample opportunity probably at the next hearing to speak. I don't think we're going to have enough time today even for the witnesses who we have lined up.

ASSEMBLYMAN HENDRICKSON: I have just one question.

ASSEMBLYMAN FLYNN: We have two experts next, three representatives from the State, including the Motor Vehicle Director. I don't want to inconvenience them at all if I can help it.

ASSEMBLYMAN HENDRICKSON: If I may, Mr. Speaker, and we totally agree that you have brought this problem to light. We have in front of us the borough tax assessor's calculations at market value in that area. In fact, it is on that block and lot number, and they have the land appraised at \$32,500 and the building at \$47,700, for a total of \$80,200. But, when they bring in their ratio to market at that, it stipulates here that the market value of the property in question is \$112,700. Now, that is at market value. That is a big difference from replacement cost at new that we have been discussing.

ASSEMBLYMAN KARCHER: Let me say two things. Number one, as to the evaluation of the building, there are three approaches to it, and you'll hear from the real estate expert about that.

As to the land and the \$32,000, what I get is that it doesn't lease any land at all. It doesn't say anything about parking. We get leases which say, "We're renting this building, plus we're renting twenty-two parking spaces." This doesn't say anything about what we're renting.

The land at \$32,000 -- maybe that is one acre -- one acre at 43,000 square feet will park 120 cars. We're not renting that; we're renting eighteen spaces in front of the building. That is all that is there. So, to put in \$32,000 worth of land cost is crazy. That is ridiculous.

ASSEMBLYMAN HENDRICKSON: I don't think you heard me, Mr. Speaker. This is the assessor's statement.

ASSEMBLYMAN KARCHER: I heard you. What I think might be--

ASSEMBLYMAN FLYNN: Let me clear this up. There are six acres there. There are either two or three buildings there on the six acres. I'm not sure what the assessor is including in the land, and I think we may have to follow up on that.

ASSEMBLYMAN KARCHER: It is not subdivided, John, but I think what might be very enlightening to you is a record of the tax appeal. I would emphasize to the Committee in the strongest terms that what you really ought to look at is Mr. Blane's appraisal. Mr. Blane is the man

who leased this building prior to the State, negotiated this lease with the State without the State ever asking him what he paid in rent, and he is the same man who prepared an appraisal, and at the same time in 1982, he filed a tax appeal to the Monmouth County Board of Taxation. Now, nobody can find that appraisal. That is very, very strange that nobody can find that appraisal.

But, you should find that appraisal, John, and you should look at what the man who negotiated this lease said the property was worth.

ASSEMBLYMAN HENDRICKSON: Was the appeal granted?

ASSEMBLYMAN KARCHER: The appeal was granted. It was lowered by consent judgment.

ASSEMBLYMAN FLYNN: You see, what we have got to determine is how much of the total six acres attribute to the land value for the Motor Vehicle agency, and then we want to find out how much of the lease includes additional space besides just the space that the building sits on. In other words, are we buying one acre, two acres?

ASSEMBLYMAN KARCHER: Let me just conclude by saying that there is a memo in the file where you'll see that they tried to support the total return on equity by saying that we've got two acres. We didn't get two acres. We got eighteen parking spaces.

Why the hell would we want two acres? With two acres, you can park 400 cars? Why would the State want to rent two acres? Can you imagine 400 cars. You couldn't even get 400 people into this building at one time. It is silly.

ASSEMBLYMAN FLYNN: All right, let's finish up with Mr. Karcher, and then we'll go on to the experts.

ASSEMBLYMAN KAVANAUGH: I just wanted to let you know that I wanted to check to find out why Route 34 was closed. I just had a call placed there, and it was only closed for two days in order to do black-topping. It is now open again, so the access is for both.

ASSEMBLYMAN FLYNN: Okay, I'd like to call Mr. Marzell. Mr. Marzell?

ASSEMBLYMAN KARCHER: I thank you for your time, attention and patience.

ASSEMBLYMAN HENDRICKSON: Thank you.

ASSEMBLYMAN GILL: We enjoyed every minute.

ASSEMBLYMAN FLYNN: Mr. Marzell, do you have additional copies of your report?

**P A U L M. M A R Z E L L:** Yes, I do. I have a copy for everybody.

ASSEMBLYMAN FLYNN: All right, we don't quite have enough for the full Committee, so we're going to have to share a little bit down that end.

Mr. Marzell, you passed out a report, and on your letterhead, it says "Marzell Appraisal Company, 55 Main Street, Millburn", and it says, "Real Estate Appraisers and Consultants." I wonder if you would give us your background.

**MR. MARZELL:** My background in real estate--

ASSEMBLYMAN FLYNN: Before you do that, I want to swear you in. Will you raise your right hand?

WITNESS, BEING DULY SWORN IN, TESTIFIED AS FOLLOWS:

ASSEMBLYMAN FLYNN: All right. Give us your background, please.

**MR. MARZELL:** I graduated from college, receiving a Bachelor of Arts degree. I attended graduate school in pursuit of a Doctorate in psychology, and I attended the United States Army Medical School in Fort Sam Houston.

My background in real estate began in 1964 when I worked in the field as an appraiser for Louis Schlesinger Real Estate Company. In 1969, I received my salesman's license, and I pursued industrial real estate, again, with Louis Schlesinger Real Estate Company of Newark, New Jersey.

Over the years, I had become involved with the David Kroheim Real Estate Company in Chatham, which developed industrial parks throughout the State of New Jersey.

In 1976, I started my own real estate company, and at the same time, a real estate appraisal company.

Currently, I am running a real estate appraisal and consulting company in Millburn, New Jersey pursuing real estate appraising of industrial, commercial and residential properties throughout the State and throughout the country.

ASSEMBLYMAN FLYNN: How many appraisals do you do a year?

MR. MARZELL: I would say in excess of 300.

ASSEMBLYMAN FLYNN: All right, and what is the ratio of commercial, industrial and residential?

MR. MARZELL: I would say 90% of my work is office, industrial and commercial properties.

ASSEMBLYMAN FLYNN: Do you work for any major corporations?

MR. MARZELL: Right now I'm representing American Bell in reviewing their leases on all of their properties throughout the United States. I've represented C.P.C., which is Corn Products Company in Englewood Cliffs, New Jersey. I've represented B.A.S.F. in Kearny, Altman's in the Meadowlands, various attorneys throughout the State, Xerox Corporation, and AT&T. This is basically just to name a few of the companies I've represented.

ASSEMBLYMAN FLYNN: Before we get into his testimony, do any members of the Committee want to ask Mr. Marzell any questions concerning his credentials or his background?

ASSEMBLYMAN KAVANAUGH: The only question I have is, have you ever done anything with Speaker Karcher's law firm?

MR. MARZELL: No, I have not.

ASSEMBLYMAN FLYNN: All right. Mr. Marzell, you have given us a lengthy report, and I've only had a chance to scan it, but I noticed that you've come up with what looks like three different approaches to appraising a specific piece of property. Is that right?

MR. MARZELL: That is correct.

ASSEMBLYMAN FLYNN: Perhaps you can just give us an overview of the approaches and the relevance of those approaches to our Committee.

MR. MARZELL: All right. In regard to appraising a piece of property, in a case such as this, we're trying to arrive at market value, whether that be market value of a property for sale, or to establish a fair rental value for a particular piece of property.

There are three standard approaches that are used. One would be the market data approach. The second approach would be the cost approach, which would be either reproduction or replacement cost less

depreciation to arrive at a current value, and the third would be the income approach, which is used in the majority of cases, and usually holds much weight in regard to any property that is income producing, and is sold on the market as income-producing property.

ASSEMBLYMAN FLYNN: Would property such as Motor Vehicle agencies be better done with the income approach, or would you do all three? What would you do if you were starting from scratch and designing a procedure? What procedure would you design?

MR. MARZELL: I think there are two procedures, and I included two things. One would be, what would a prudent businessman do in beginning a search for space that he would have to utilize for whatever his particular purpose? This would basically be along the avenue of making a location survey from a real estate point of view.

When I mentioned the three different approaches, the other part would be really in regards to the appraising value of properties, so there are two different sectors here.

I think the first one, in regards to making a location survey, would be procedures one would use in order to go out and get an understanding of what is available on the market and what the market rents are in a particular area at that time based on your specifications.

ASSEMBLYMAN FLYNN: So that would address the question that Assemblyman Hendrickson raised earlier, and that was, are there other alternative sites in the area that you want?

MR. MARZELL: That is correct.

ASSEMBLYMAN FLYNN: That is what you would do. I suppose if there weren't, you would have to pay a little more. As a prudent businessman, if you want to be in a certain location, and you don't have alternate sites, then you have got to pay what the traffic bears on the site you want. Is that right?

MR. MARZELL: That is correct.

ASSEMBLYMAN FLYNN: If there are alternate sites, then you have a negotiating tool.

MR. MARZELL: I think that before a person can make a decision, he really has to investigate the market, and there is a certain procedure that I would like to go through briefly.

ASSEMBLYMAN FLYNN: Okay.



MR. MARZELL: I have put down five categories, and it is attached to the report.

ASSEMBLYMAN FLYNN: Is that on page 3 of your report?

MR. MARZELL: That is correct.

ASSEMBLYMAN FLYNN: All right, so for the benefit of the Committee, he is talking about page 3 where it says, "Location Survey Method."

ASSEMBLYMAN HENDRICKSON: I have a question. This is not really an appraisal report; this is generally what you actually do. This is your methodology?

MR. MARZELL: That is correct.

ASSEMBLYMAN HENDRICKSON: I want to bring a point out here that this is not an appraisal report on the income approach to the building in question.

MR. MARZELL: No, I was not asked to prepare a particular--

ASSEMBLYMAN HENDRICKSON: Excuse me, you were not asked to prepare for us an income approach to value. You are not prepared to give me a gross rent multiplier for that area?

MR. MARZELL: I can give you my opinion based on my inspection of the property and what I know. That is correct. But, I have not prepared a formal appraisal report of that specific property.

ASSEMBLYMAN HENDRICKSON: As a certified review appraiser, can you give me an analysis of the gross rent multiplier for this type of commercial property in the area? Are you familiar with what I am asking?

MR. MARZELL: Yes, I would give you a cap rate, a rate that one would use--

ASSEMBLYMAN HENDRICKSON: Is there a difference between a cap rate and a gross multiplier?

MR. MARZELL: It is basically reciprocal.

ASSEMBLYMAN HENDRICKSON: Well, through one of the approaches, yes, but you need them both.

MR. MARZELL: Right. I think if I use the cap rate--

ASSEMBLYMAN HENDRICKSON: Don't misunderstand me, I'm just looking for information. If I appear that way, I apologize.

MR. MARZELL: That is okay. I could give you information on my approach to that particular property. I didn't pick up specifics, other than making a review of the area, and I have had discussions with various people. But, my basic intent in this case was to show some procedure; that would be used, and basically what I found when I went down to look at that property, and how I think it stands.

ASSEMBLYMAN HENDRICKSON: I was under misinterpretation as it was handed out.

ASSEMBLYMAN FLYNN: John, for the benefit of you and the Committee, since this Committee is overviewing all the leases and all the procedures, basically Mr. Marzell is here to tell us what he as an expert feels we should be doing. So that we, then, in our report -- we're not zeroing in on any one location.

ASSEMBLYMAN GILL: That is right.

ASSEMBLYMAN FLYNN: In our report, we want to say, "Here's what the State should be doing if they are not doing it now." Maybe they are doing it now, but he's giving us his expert approach as to what the best way is as far as he is concerned.

ASSEMBLYMAN HENDRICKSON: Just to clarify it, I am an I.F.A. and a C.R.A. and a few more, and that is what I do for a living.

ASSEMBLYMAN FLYNN: I.F.A. What is an I.F.A.?

ASSEMBLYMAN HENDRICKSON: Independant fee appraiser.

ASSEMBLYMAN FLYNN: Okay, so the Location Survey Method on page 3 -- perhaps you could just give us an overview of what is entailed.

MR. MARZELL: Okay. I broke down the survey into five particular steps.

The first step, I would assume would be the advanced planning that any group would go through before they look for space. That would be trying to define the objectives of renting space. The other would be defining their particular requirements to suit their particular function.

The next would be a preparation of your location specifications. One would make a survey in regards to what areas of the State might need a Motor Vehicle agency, for example -- what area seems to be a key area? The would sort of establish a primary and a

secondary location area. Transportation would also play a role in that and availability of space.

The third would be procedures that they would use to actually seek space. One would be their own staff -- how many people would they need to represent them in order to actually go out and make contact to find out what is in the market? The second would be to rely on other organizations that would be available to give them information on the real estate market. Those would be brokers, owners of property, and tenants in a particular vicinity in which they are seeking property. They could also contact builders and developers in the area, and the tax assessor is a source of information; so would the building inspector and the zoning board.

After that type of preliminary investigation and survey, hopefully they would have accumulated enough statistical data to try to seek out where a primary location would be, and what would be available there, and what might be a secondary location if nothing could be found.

They would also have some statistical information on building costs, building sales, asking prices for building, and rental asking prices. Also, they would have to deal with some idea of what land values are -- what has land been selling for, and what has parking or land renting for?

The next thing they would have to do is take that data and try to organize it, identify the important aspects of it, and then separate it into categories.

The next step they would try to do, and if you try to analyze the whole thing, is a comparison-type shopping. They would take the various factors such as locational factors and physical factors of the building, which would include its age and condition, and various amenities -- ceiling heights, floors, air conditioning, wall covering --functional utility of the building to determine if that building will serve its purpose to the particular needs of the shopper, and lastly, the economics. Is this building suffering from any kind of economic obsolescence? Is there any excess in the building? Does it appear that the market is going to decrease in value over the next couple of

years? Are certain improvements too costly to be made to justify the rent and the return for your particular purpose?

One would then weigh these factors and analyze and interpret them; then they would go about selecting the property that best suits their purpose at the most economic price. That actually would be a thorough real estate function in searching and seeking out a location.

ASSEMBLYMAN FLYNN: All right. Assume you have maybe four or five sites, and you would then assign a weight factor. As Mr. Kavanaugh, this is an ideal site. Take the Matawan one, for example. Mr. Kavanaugh said it is an ideal site, so on a scale from one to ten, you might give that an eight or a nine. Now, you might have another site that is a six or a seven. How do you evaluate that with cost per square foot or other things to determine which is the better buy, so to speak?

MR. MARZELL: Right. In this report, and this is also the primary function in doing appraisals of property when we use the market data approach. We take properties and we know that no property is identical, and we try to compare them. We compare them on their rental value or their sale value to other properties.

In my report on page H, I give definitions of a list of adjustment factors. If we have five or six properties in an area, we try to break them down by square foot per building and square foot or acre or front foot of land area. Knowing what we would require for parking, we would try to compare these properties in regards to our particular purpose. So, we would take the actual features of the building and compare them item for item. We would try to evaluate what each building is worth, or what the rent is for each building per square foot. This is one way that we would begin to analyze the five or six sites that we might have selected in the area. Whichever one appears to come closest to our specifications and at the most reasonable price would most likely be the building we would select.

ASSEMBLYMAN FLYNN: Are you familiar with parking necessity in a building such as a Motor Vehicle agency as to how many spaces might be necessary?

MR. MARZELL: No, I'm not. The only knowledge I have with that is in regard to the particular building in Matawan.

ASSEMBLYMAN FLYNN: Let's say you have a building that is doing maybe 500 items a day. I think we've got a figure; somebody gave us a figure of 500 items a day. I don't know if that is a fact or not, but that is in our packet. If you assume 500 items a day for an eight hour day, how many parking spaces would you need?

MR. MARZELL: I don't know what an item would be. Would that be an actual transaction?

ASSEMBLYMAN FLYNN: For example, Mr. Kavanaugh said a man came down from Linden with a bunch of them. I guess each one of them would be considered an item. Is anyone here who is an expert in knowing what an item is?

RESPONSE FROM AUDIENCE: (Inaudible response from audience.)

ASSEMBLYMAN FLYNN: A transaction. In other words, if I go down to renew my license, that is an item. I get a new registration. Is that an item?

RESPONSE FROM AUDIENCE: That is correct.

ASSEMBLYMAN FLYNN: Okay, so if a car dealer goes down with maybe ten, that would be considered ten items. Is the figure 500 accurate for the Matawan one?

RESPONSE FROM AUDIENCE: It is closer to about 700.

ASSEMBLYMAN FLYNN: A day?

RESPONSE FROM AUDIENCE: Yes.

ASSEMBLYMAN FLYNN: Okay. So, now you know what an item is. I'm not sure we could translate that into--

MR. MARZELL: How long does it take to put through an item?

ASSEMBLYMAN FLYNN: Well, I guess there is no set standard unless maybe our experts will be able to tell us there is. If a dealer goes down with ten items, that is going to take a lot less than each individual person doing an item by himself.

Does anyone have any figures on what the standard time would be for an item?

RESPONSE FROM AUDIENCE: (Inaudible response from audience.)

ASSEMBLYMAN FLYNN: A twenty minute turnaround. I think rather than have you sit there and do calculations, I think what we'll do is generate as much information as we can, put together a fact package, and then perhaps ask you to give us a written report based on the

fact package. There are too many variables that we don't know off the top of our heads until we really talk to the Motor Vehicle experts.

Yes, sir?

ASSEMBLYMAN KAVANAUGH: You brought up economic obsolescence, and as an expert in your field, do you agree that economic obsolescence in an appraisal is the exterior of the building?

MR. MARZELL: Yes, I do.

ASSEMBLYMAN KAVANAUGH: And, physical obsolescence has to do with the building?

MR. MARZELL: That is correct. Economic obsolescence has nothing to do with the building.

ASSEMBLYMAN KAVANAUGH: Would you have a weighted factor in the neighborhood influence? Would it also be part of the economic obsolescence or the economics of the area that would generate some attitude toward the leasing problem?

MR. MARZELL: Yes, it would.

ASSEMBLYMAN KAVANAUGH: When you make an appraisal from the three approaches, at the conclusion, would you weigh which of the values would be the weighted value for your client? In other words, in a building that is leased, would you give him a cost of reproduction as the weight, or would you give him the income of the building, less all the costs of the building, as the weighted approach for that building?

MR. MARZELL: I think it would really vary based on specific requirements.

ASSEMBLYMAN KAVANAUGH: I would give whatever the client would request.

MR. MARZELL: Yes, I consider all approaches. Sometimes when one approach takes favor over the others, I think--

ASSEMBLYMAN KAVANAUGH: That is what I'm trying to get at.

MR. MARZELL: Right. I would say that usually when we are talking about investigating properties for the purpose of leasing them, the income approach and the market data approach are the two which would really have more weight than that cost approach.

ASSEMBLYMAN KAVANAUGH: I have one other question. In your experience with your clients, and I will say because of some experience

that I have, each client might ask you to do the appraisal because he, in his economic bracket, needs a certain percentage of income. Some buildings will generate certain types of income because they are income products, and others will do different things for different people because of what they need as part of their income in their investment portfolio.

MR. MARZELL: When I evaluate property, I do it based on what the market bears. I do not turn to my client and ask him what he is looking for, if that is what your question is. I don't try to support a figure for my client.

ASSEMBLYMAN KAVANAUGH: Well, no, that is contrary to your profession. I agree with that.

MR. MARZELL: Right, I'm asked to go out and objectively seek out value. Many times, a client will ask me, "What do you think it is worth?" I say, "I haven't begun my investigation yet. I really don't know." We can talk in terms of ball park, but I think it is dangerous though. I try to do my investigation and then say, "My work has resulted in this data, and based on this data, I have drawn these conclusions."

ASSEMBLYMAN KAVANAUGH: Basically, that is what I'm asking -- that there are many, many times you will have to weigh the income approach, or you would weigh the income approach just from your facts -- what you have found in the market.

MR. MARZELL: Right. Sometimes that really says it all. The income approach really dictates.

ASSEMBLYMAN KAVANAUGH: That is what I'm trying to get at. Thank you.

ASSEMBLYMAN FLYNN: I have a question. On the last page of your report, page L, you set forth 1982 Dodge Construction System costs. At the bottom you've got Gross Building Costs, and you came up with a couple of figures. There is one, \$33.90, for light manufacturing buildings, and \$40.00 for such things as stores and shops. Would that hold true in 1983?

MR. MARZELL: No, not really. First of all, these figures are put together by a large outfit that reviews thousands of buildings that are being constructed throughout the country. These figures do



vary from year to year, and they also vary from building to building. If one were to review the bids on any particular project, there is always variance among the builders. You could have a 10%, 15%, 20% or even a 50% variance in bids when people bid on a project. These are the rules of thumb primarily.

ASSEMBLYMAN FLYNN: Let's take, for example, since you said you are familiar with the building in Matawan, all the costs using the most recent cost estimates to build it from scratch.

MR. MARZELL: My opinion, after reviewing the building, is that number one, it is not a typical office building as of last week when I inspected the building. It would fit more in line with a retail or commercial store type of building, which would be air conditioned. That is another topic in itself as far as the amount of tonnage they are utilizing.

I felt that the building, if it were replaced today, would probably cost in the vicinity of \$45.00 per square foot. That does not include value. Those are improvement values only. That also does not include any personal property, which I would consider the large counter that was built. That actually bisects the 1300 square feet into two separate sections.

ASSEMBLYMAN FLYNN: All right. Will you multiply that? I don't have a calculator.

MR. MARZELL: I think it comes out to \$58,500.

ASSEMBLYMAN FLYNN: To build it brand new.

MR. MARZELL: Yes.

ASSEMBLYMAN KAVANAUGH: Does that include the land?

MR. MARZELL: No, that is only the physical improvement of the building.

ASSEMBLYMAN FLYNN: How much land would you say would be necessary to support the structure that you've seen?

MR. MARZELL: Without going into the item aspect that we were discussing before, based on my inspection, when I was down there I was shown that there were eighteen cars and eighteen parking spaces that were lined on the pavement in front of the building. A few of those spaces were for handicapped, but they totalled out to eighteen spaces.

We have a 1300 square foot building. It has been my experience that for office buildings, a ratio of four to five cars per thousand is typical. This, again, is not an office building. This is a specialty use Motor Vehicle building. The building itself could fall in the range of some type of commercial operation.

So, let's assume that we have eighteen parking spaces to serve this building, and allotting approximately 350 square feet per space, when we multiply that out, I would feel that a 1300 square foot building, as this building is, would need a total land area, including the land under the building, of not in excess of 8000 square feet. That would be total land area necessary to support the facility as it was when I inspected it.

ASSEMBLYMAN FLYNN: All right. In that area, and I don't know how you want to define the area -- whether you want to define it by county, town -- how would you tell us what square footage in that area is?

MR. MARZELL: My preliminary investigation really did not delve into other rentals. I did make some contacts to get some information as to what was actually taking place in the area.

A few of the questions I asked were, "What other space is available in the Borough of Matawan?" I talked to a party who owned a building on Main Street, which is about a mile from the location of the subject property. It was a medical building, and there was 1500 square feet of space available. Now, a medical building, which is more along the lines of an office building, is also specialized space. I would say it would have a higher value than this particular building in the condition that I found it upon inspection. They were asking \$85,000 to sell 1500 square feet as a condominium. They were asking \$950 net as a rental value.

On the same street as the subject property, Route 34, just south of it, was a brand new shopping center which was under construction. It is due to be completed within the next two to three months. They are asking \$12.00 net for brand new space in the shopping center.

Those were the prices that I was quoted, but I didn't go into any further investigation other than asking.

ASSEMBLYMAN KAVANAUGH: When you say \$12.00 net, what is that net?

MR. MARZELL: Twelve dollars net would mean that this is the income that is paid for the space to the owner of the property. The tenant would have to pay other costs, such as utilities, taxes, and sometimes tax escalation. It really varies.

ASSEMBLYMAN KAVANAUGH: So, the \$12.00 net a mile away is the same net that we are talking about at a very good location at Route 34 and Broad Street.

MR. MARZELL: Number one, the \$12.00 net was an asking price, but what they actually come down to when they negotiate, I don't know. But, this was for a brand new shopping center, not a 15-year old building. It had all the amenities of a modern shopping center. That was one figure that was quoted.

ASSEMBLYMAN KAVANAUGH: Heavy traffic and all those other things.

MR. MARZELL: It was on Route 34 in the southbound lane. The subject property is basically in the northbound lane.

ASSEMBLYMAN KAVANAUGH: But it is not as ideal. For example, you have seen the building, the existing building.

MR. MARZELL: Yes, I have.

ASSEMBLYMAN KAVANAUGH: You can see that it has ample parking. You don't have to worry about women with packages driving in and out and hitting the other people as they are getting their motor vehicles inspected. If you, in your judgment, as an appraiser, had to make a decision to go a mile down the road to the new shopping center with a great number of cars and pay \$12.00, or go to an area, which as a businessman, I feel is ideal, for \$12.00, which would you take?

MR. MARZELL: I wouldn't take either. I certainly wouldn't go into a building just based on locational differences like you're talking. I think there are certain good points about this building.

Number one, it is not in a shopping center where you would have this traffic. It is not a storefront operation where you would have to find public parking, or maybe even have to walk a few blocks. It does have parking adjacent to the building.

But, if I were to look at the building very quickly and take the cost to build that building new, then take the land cost, I would

have to try to figure out what a prudent investor would want for return on his money, based on the economic market at that time. Attached to my report I included some of the statistics on the prime rate.

But, if we made an assumption that at the time that a particular investor or an owner would want to make a 14% return on his money, we would come up with a net rent below \$9.00 a square foot.

If I were seeking space, right away I would say, "I'm not going to pay \$12.00 net, plus other tack ons, if a 14% return would show a figure below \$9.00 net. If I liked the building, I would negotiate it and try to bring it down to what would be reasonable. I would compare it to other rents in the area.

For example, this is a 15-year old building; it is not a brand new shopping center. A brand new shopping center draws basically commercial enterprises, and they will pay a much higher value to be in a shopping center. These people are trying to captivate that market, and they know that that market will bear \$12.00 net. If I were, let's say, Crazy Eddie's or some other particular commercial operation, it would be worth it to me to pay \$12.00 net or even \$14.00 or \$15.00. But, a Motor Vehicle agency wouldn't want to necessarily locate in a brand new mall.

On the other hand, for a medical building and professional building in town, with all the amenities that most of the nice professional buildings have, they are talking \$9.50 net for a building which is almost the same age as the subject property. The only feature that the subject property has over a medical building is that this is a free-standing building as opposed to being in a multi-occupancy building.

ASSEMBLYMAN KAVANAUGH: With a single purpose.

MR. MARZELL: Right, so that would a difference.

ASSEMBLYMAN FLYNN: Before we go on to another question, I just want to tie this one question up. We got off on a tangent. We're trying to find out what 8000 square feet of land is worth.

MR. MARZELL: All right. I didn't go into a land investigation, but if one were to review the assessor's tax card and make the assumption that the assessment on that card is correct, that the assessor evaluated the market value for land sales, they were saying

that the land was worth \$55,000 based on front footage for that one particular segment of the six-acre site. The area they were talking about was 22,000 feet at \$55,000.

The subject property only requires 8000 square feet, so let's say that we come up with a land value of approximately \$27,000.

ASSEMBLYMAN GILL: Well, Mr. Marzell, if the particular parcel of land has more than 8000 square feet, what is customary? Is it 10,000, 12,000? Don't you rent the whole piece? You don't chop it up, do you?

MR. MARZELL: No, in this particular case, there are two other buildings which are probably situated on the first acre of land. This is one free-standing building, and there is another one to its south, and still another one to the rear. One is occupied by a real estate broker, one is occupied by another company, and the other is occupied by the owner of the total six acre site, which I think is New Jersey Materials Company.

There is paved parking in front, but it is shared in common with the adjacent real estate broker's office. When I spoke to the people at the Motor Vehicle agency on the site, they told me that they were utilizing eighteen spaces. But, the gentleman didn't have any knowledge as to how that was incorporated into the lease -- whether they specified spaces or specified land area or if any of that was in the lease at all. It was just standard procedure that they gave him eighteen spaces.

ASSEMBLYMAN FLYNN: Is there a standard practice that when you lease space from a larger parcel, either by meets and bounds or in some other way, to delineate the leased portion?

MR. MARZELL: It depends upon the lease. It doesn't happen in all cases. Usually they specify parking spots that they allot.

ASSEMBLYMAN FLYNN: What would be the best practice? For example, you have an unusual site. You have six acres, three buildings, and they are all on one big lot. It is not divided into lots. Apparently there is a lot of common parking. What would be the best practice for the State in drawing its lease?

MR. MARZELL: I would say that the best practice would be that once they determine the number of spaces they need, then they would make a review of the actual land area that they would need to support that. But, I think it should be specified either as parking spaces or by a leaps and bounds description that you will utilize so many square feet of a subject land area, and then you would have someone go down and measure it to give you a meets and bounds description of that area, if that can possibly be done.

If that can't be done, or if the owner will not do that, then you should have the owner specify exactly which spaces are involved and if they will be shared in common or be marked spaces. In other words, will they be private parking?

ASSEMBLYMAN GILL: Do you know how many spaces, how many square feet, and what the acreage was in this particular lease in Matawan?

MR. MARZELL: I knew how many spaces there were.

ASSEMBLYMAN GILL: I know how many spaces there are, but do you know how many are in the lease? In other words,--

MR. MARZELL: I did not see the lease.

ASSEMBLYMAN GILL: The implication is that this entire parcel of ground has "x" number of square feet. You only need "x" number of square feet. Do you know, for example, what the lease calls for? Do you know, for example, that it just might say that what we need, what is in the lease, and what we are paying for is only eighteen spaces? Forget the rest of it.

MR. MARZELL: When I met with Speaker Karcher, I was not given the lease, and I was also told that there was nothing in the lease with regards to parking, so I inspected the property. There was no recording in the tax assessor's office, nor did the gentleman who ran the Motor Vehicle agency know how many spots were given, other than the fact that he was told that these eighteen spots were being utilized by his building.

ASSEMBLYMAN GILL: I appreciate that, but the implication is that there is a lot more space out there that is going to waste. Do we know that for a fact?

MR. MARZELL: I don't know that for a fact.

ASSEMBLYMAN GILL: Okay. Let me just ask you a broader question. What you have here is, in effect, a guideline, that is very good. We've been talking guidelines all morning.

Do you feel that by using this as a base, we can establish guidelines for the rental of not only Motor Vehicle agencies, but also State-owned spaces?

MR. MARZELL: Absolutely.

ASSEMBLYMAN GILL: Do you happen to know what was used in the past by the previous Speakers to regulate what should be approved and what should not?

MR. MARZELL: I don't know what was used, but some of the papers that were given to me to review had to do with the State's evaluation of this particular property, and Speaker Karcher asked me what I thought about it and what it really meant to me.

What they actually had done was, they used other Motor Vehicle agencies throughout the State. I think they had three or four sites that they used. Now, these are in totally different areas, which really had nothing to do with the market value in Matawan, the Borough of Matawan. It showed various rentals of \$17.00, \$18.00, \$19.00 per square foot, but that has nothing to do with market value when you are seeking a specific site.

I think the best thing that the State could do is to have a team that will go out and investigate properties, just like a real estate broker does or any person seeking space. This team should go out and ask the right people the right questions to find out what the market value really is. What are asking prices? What are people signing leases for? What is available? Why are there differences?

If a guy pays \$15.00 per square foot down the block, and another pays \$12.00, there must be some reason. That is the way to approach it.

ASSEMBLYMAN GILL: I have just one last question. Is it fair to say-- You can't say it is outrageous to do this much without looking at each site in its own particular way.

MR. MARZELL: Absolutely, I think you have to really investigate the site.

ASSEMBLYMAN FLYNN: Assemblyman McEnroe?



ASSEMBLYMAN Mc ENROE: My only comment is that I am very pleased with what you just said because I think that is the crux of the discussion. I think Mr. Marzell's testimony is expert testimony, but I wonder if it is relevant to the Committee's inquiry. I just think it should be directed to the Department of Property Management with the recommendation from this Committee that it is important material which should be looked into very thoroughly.

Your final comment dealing with reviewing the value of real estate with people in that area, I think, makes a lot of sense. I still think we should get into some questions that prompted this--

ASSEMBLYMAN FLYNN: Well, that will come next.

ASSEMBLYMAN Mc ENROE: Okay.

ASSEMBLYMAN FLYNN: I have one last question. Do you think that the kind of review by a team should be an in-house or an out-of-house consultant type thing? Which would you recommend?

MR. MARZELL: That is a difficult question, and that is my profession.

ASSEMBLYMAN FLYNN: Assuming for a moment that you will not be the out-of-house consultant--

MR. MARZELL: I think what should be done is, you should have an in-house staff who will coordinate their effort with outside people. They should definitely rely on outside personnel, but to say that they should totally rely on outside personnel or one particular party on the outside, I don't necessarily think that would be the answer. I think it should be a coordinated effort.

ASSEMBLYMAN FLYNN: How much time would be required to do the kind of job that you have laid out in your location survey method -- to do a proper job? How much time would be required?

ASSEMBLYMAN FLYNN: Well, like I advised some large companies that were giving four months to determine whether they wanted to renew a lease or not, I would say that for this particular thing, you would have to give yourself six months to a year-- I would say at least a year before your lease comes up.

ASSEMBLYMAN FLYNN: I'm not talking about that. I'm talking about the actual man-hours to do the right kind of job as you've

suggested. How many man-hours would it take? I'm not talking about the length of time, but the man-hours?

MR. MARZELL: I would have to calculate that. I really haven't come up with the--

ASSEMBLYMAN FLYNN: We're talking hundreds of leases, and we have got to talk about the real world. The State has "x" number of employees, hundreds of leases, "x" number of dollars, and I read somewhere where the Division of Vocational Rehabilitation has \$75 million worth of leases to do, and nobody has the time to do an on-site inspection because they don't have the personnel. So, we have got to deal in that framework.

Just give me an estimate. How many hours -- ten hours, twenty hours?

MR. MARZELL: Per property?

ASSEMBLYMAN FLYNN: Yes, per property, in order to do the right job. If you don't want to be pinned down today, give us some thought and supplement your report, because we may be giving the department a burden that they can't handle unless we give them millions of dollars more.

MR. MARZELL: I would like to give it some thought and try to come up with an answer. That is why I also say that it should be a coordinated effort. If you turned to outside people who do this daily, and that is their business -- real estate brokers, developers -- they are out there every day. They know their area. To turn to reliable people on the outside who are in continual contact with their particular market would save time.

ASSEMBLYMAN FLYNN: That is why I said in-house or out-of-house. Maybe we have to have the in-house people supervise the out-of-house consultation in order to do the best job.

MR. MARZELL: That is right.

ASSEMBLYMAN KAVANAUGH: I have a question. How do you deal with parking? When you're doing the appraising, and you bring in the numbers we talked about, units and what have you, the concern that I have -- this is a unique type of operation. It is the same as Motor Vehicle inspection stations. If you go there on the eighth or the ninth or the tenth of the month, you can drive right in, get your

emission test, and drive right out. In most cases, I'm sure you would take into account-- Maybe you could give us your opinion on that. What do you do in a case at a Motor Vehicle agency where, if you chart it, you see 700 units there for renewal as you get to the end of the month? This is not a budget item that is evenly divided throughout the month. You're probably going to see 60% of those 700 units during the last week of the month. What do you do regarding parking places in a case like that?

MR. MARZELL: Again, I'm not clear on the exact number of units or what that means, but--

ASSEMBLYMAN KAVANAUGH: Every transaction. I'm talking about everytime they ring that cash register when someone comes in to renew his license. That is a one-unit transaction.

MR. MARZELL: One way to begin is, let's assume that the average time of a transaction is fifteen minutes. Let's just use that as a--

ASSEMBLYMAN KAVANAUGH: Well, they use twenty minutes.

MR. MARZELL: All right, twenty, so that means in one parking spot, you can service three people per hour. Then you would multiply the number of parking spots by the number of hours in the day. This would give you some idea of the capacity for those transactions.

I don't know what you would do with overflow. I'm not familiar with the Motor Vehicle agencies throughout the State. I've never really made any investigation into how they handle their parking.

ASSEMBLYMAN KAVANAUGH: This is a unique operation. It is something that is easy, and certainly you have the expertise in your field. It is the same as I said earlier; it is location. If it is a mile down the road or wherever it is, what they will do is, they will put more people at the counter during the last week of the month. So, you may have eight people working. If you're doing three transactions, that would give you twenty-four transactions going at the same time. This is one of the reasons why you have to have ample parking, and that now brings cost up when you're talking about leasing. You don't need that.

You can buy a place at \$12.00 per square foot with four parking places, but it is conceivable when you are talking about a

Motor Vehicle agency and really loading it up, you may need 200 parking places. And, that costs more money. It is like buying a building, and if you want to use it as a bank, you've got to put a vault in. So, that is going to cost you more money.

MR. MARZELL: I think one question would be, is it economically justifiable to lease a lot of land? For example, most Motor Vehicle agencies that I've been to for my own personal use have been for operations where there was only--

ASSEMBLYMAN KAVANAUGH: And, you've written letters to the Legislature saying, "What the hell are we doing in the State of New Jersey?" I've got piles of those, and we don't want those.

MR. MARZELL: I went in and out as fast as I could.

ASSEMBLYMAN KAVANAUGH: We want efficiency in the operation. We want the people who are paying money to get a return on their tax dollar. We are sitting here and forgetting the political party. We are sitting here trying to make sure that an operation that has gone downhill comes back. Now I think we're going in the right direction, and I hope it continues, whether we have a Democratic Governor or a Republican Governor the next time. I hope that we can see this efficiency so that people are pleased.

MR. MARZELL: When I was at the building, I spoke with a gentleman who was actually handling the operation down there. He told me that he requested the eighteen-car parking, and he found that it was very good for his particular operation. He was proud of the building, he felt that the building was serving its purpose, and there were no functional problems, which would include a problem with parking. At least from his point of view at that particular time, the eighteen cars which were on-site seemed to handle his particular purpose. If it would everyday of the month, I really don't know. I think somebody would have to do some research in that area in order to have some idea of what are the necessary requirements during bulk days during the end of the month, as you were saying.

ASSEMBLYMAN KAVANAUGH: Would you in your expert opinion say that if you need more parking, it is going to be more cost for the lease?

MR. MARZELL: Yes, and then I would try to figure out how much more parking is justified. If we have two heavy days of the month, does it justify us spending another \$10,000, or would it be better if people who don't want that last minute rush to spread their time out over the month for renewals or whatever else they would utilize a Motor Vehicle agency for?

ASSEMBLYMAN FLYNN: All right, are there any other questions of this witness before we go to the next witness?

ASSEMBLYMAN HENDRICKSON: I have just one question. We've been talking parking space here, and we seem to be awfully oriented toward parking and the size of the spaces. From your experience, have you gone into Matawan's zoning ordinances which say that each building shall produce so many parking spaces as long as it is a permitted use?

MR. MARZELL: No, I haven't, but every town has parking requirements, and they vary based on their use. This property, I think, is commercially zoned, so therefore, they would establish how many cars per square foot of building they would allow.

ASSEMBLYMAN HENDRICKSON: Therefore, that would have to be in the lease because of the local economy or what we know as home rule.

MR. MARZELL: Yes, to be within the zoning ordinance law. That is why I mentioned that one would also consult with the zoning office, as well as the building inspector and the tax office.

ASSEMBLYMAN HENDRICKSON: That hasn't been brought up in all the testimony. That is why I'm trying to make a point of it.

MR. MARZELL: Yes, I think it is important.

ASSEMBLYMAN HENDRICKSON: In this particular case, we have to meet the local ordinances on how many spaces must be provided. So, when we talk about leasing "x" amount of square feet of property, we have to lease "x" amount of square feet of property to meet the local police power. Is that correct?

MR. MARZELL: That is correct. I think taxation also becomes another problem. I think that if you are taking a piece of property that is assessed as six acres of land and there are 25,000 square feet of building, but you are only utilizing a 1300 square foot building, and you are only utilizing so many square feet of land, you must make

some evaluation as to what your obligation is as far as real estate taxes are concerned. This, again, was something else that was not specified very clearly.

MR. MARZELL: I was using \$45.00 per square foot based on my judgment, but it is true, and I think that every cost manual, whether-- I have four or five that I review. Some are better than others in certain areas. Marshall and Swift happens to be, I think, one of the finest around.

Each one incorporates different items in a different way. Marshall and Swift might include architectural and engineering fees.

ASSEMBLYMAN HENDRICKSON: That is very important.

MR. MARZELL: Right. They also have various multipliers for your location and time.

ASSEMBLYMAN HENDRICKSON: I was going to ask that next.

MR. MARZELL: So, they all vary. I think the biggest thing is, this was just some idea that I was using with Speaker Karcher when I discussed this property, and I said that these can vary. If we can look at the individual Dodge Reports, we can see that bidding for jobs vary tremendously. We really don't know until an actual bid is accepted and construction begins. These are averages, and probably one of your best sources would be local contractors who build those specific types of buildings.

ASSEMBLYMAN HENDRICKSON: Also, would you say that construction costs of that particular contract would be a little different than if we had a contractor who had five jobs ahead of it -- eighteen months ahead of it -- or perhaps a contractor who only had two months ahead of it. He may want to keep his men working and, therefore, do it on a cost plus basis, or a very short contract, and then go out and look for additional work to keep his people working.

MR. MARZELL: There is no question about that. It plays a tremendous role in what a guy will accept.

ASSEMBLYMAN FLYNN: I have one question while we're on that topic. Maybe one of the experts from one of the departments can tell us if in the lease itself-- I haven't seen a copy of the actual proposed lease. Is there anything about parking spaces in there?

Yes, sir? May I have your name?

C A E S A R I A C A V O N E: My name is Caesar Iacavone. There is no lease because we can't execute a lease without actual signatures. The proposed lease gives us full use of all available parking associated with the site. That means we have access based on actual physical measurements made by me personally of 1.84 acres. You can park approximately 159 cars in that area. Given the volume at the beginning and end of the month of the Motor Vehicle agency, I can tell you that that should be just about adequate for peak operations.

We have a situation down in Vineland where we have a building with forty parking spaces. We're getting complaints by the Chief of Police and the local neighboring commercial businesses because we're using up all the parking. Parking is essential to accommodate a Motor Vehicle operation.

By the figures you were throwing around before, based on the volume of transactions and the number of people, I get a rough calculation that came out to a minimum. If you averaged it out, it is eighty-eight parking spaces on just a flat rate. That does not allow any leaps and bounds.

ASSEMBLYMAN FLYNN: Eighty-eight at one time?

MR. IACAVONE: Yes.

ASSEMBLYMAN FLYNN: Where was this? There is something wrong with those figures. I've been there many times, and there are never eighty-eight cars there. Maybe the twenty-minute figure is wrong, because if somebody comes down from Linden with ten, that throws that twenty-minute figure way off.

MR. IACAVONE: Plus you have your leaps and bounds.

ASSEMBLYMAN FLYNN: All right. We're going to get into that in-depth. I just wanted to find out whether or not the proposed lease had a specific number of spaces.

MR. IACAVONE: As a matter of fact, if the volume was such in the agency, the way the lease is designed, we could break it if the owner could not accommodate the parking volume. In other words, it says "adequate parking for staff and visitors." There is no limit. We have full use right now of 1.84 acres. If that would not accommodate our volume, he would have to move back his fence and clear more of that six-acre site to accommodate our parking needs.



ASSEMBLYMAN FLYNN: Thank you. Are there any other questions of this witness?

ASSEMBLYMAN KAVANAUGH: I have one question before you leave. What do you think of Speaker Karcher's method of appraising that he spoke about this morning? Do you think he has any possibility of becoming an appraiser, or should he stay an attorney?

MR. MARZELL: I think he would be a marvelous appraiser. He really seems to have an understanding of the market. I know from speaking with him and from his experience as an attorney in the tax courts, he has been exposed to a great deal of real estate debate by expert witnesses -- appraisers on both sides of the fence. I think that after that type of exposure, and his own working knowledge of real estate, he would certainly qualify as an appraiser. His opinion would be a fairly valid opinion.

ASSEMBLYMAN FLYNN: If there are no other questions, we'll call the next witness. Mr. Levitt?

Mr. Levitt, will you raise your right hand please?

WITNESS, BEING DULY SWORN IN, TESTIFIED AS FOLLOWS:

ASSEMBLYMAN FLYNN: What is your first name?

STEVEN LEVITT: Steven.

ASSEMBLYMAN FLYNN: Steven?

MR. LEVITT: S-t-e-v-e-n.

ASSEMBLYMAN FLYNN: Do you have anything written for us?

MR. LEVITT: No, I didn't know you needed it.

ASSEMBLYMAN FLYNN: All right. Sir, will you give us your background?

MR. LEVITT: Sure. I graduated from Ohio University with a bachelor's degree in Business Administration in 1966. I attended Rutgers Law School for a year, and graduated from Seton Law School in 1970. Then I attended the Master of Law program in taxation at N.Y.U. I began my career in public accounting in 1967, and stayed there until approximately 1976 when I joined Hannick, Weisman, Stern, Dessler, Berkowitz, and Kinney.

From 1969 until 1976, I was practicing only tax accounting. I was in the tax department of one of the large public accounting firms in the State. Since 1976, with Hannick Weisman, I have really been specializing in tax law.

ASSEMBLYMAN FLYNN: Does anyone want to ask him any questions?

ASSEMBLYMAN Mc ENROE: You are a member of the bar, aren't you?

MR. LEVITT: Yes, I am a member of the bar, and I am a C.P.A. in New Jersey.

ASSEMBLYMAN KAVANAUGH: Does your firm and Mr. Karcher's firm work together?

MR. LEVITT: Not that I am aware of. There may be a matter here and there, but there is no--

ASSEMBLYMAN KAVANAUGH: I am only asking that question just so that we can have it clear in case there is a conflict.

ASSEMBLYMAN FLYNN: That is a good question. Are there any other questions? Yes, Assemblyman Hendrickson?

ASSEMBLYMAN HENDRICKSON: Have you handled many leases in the area that we are talking about regarding the subject property?

ASSEMBLYMAN FLYNN: We're talking about the State of New Jersey now, John. We're not talking about any one spot or any one county.

ASSEMBLYMAN HENDRICKSON: I understand, but again, I'm interested in the area that we are speaking of and the particular leasing operation that we're trying to find out all the information that we possibly can. Are you familiar with the leasing operations in that area?

MR. LEVITT: My experience has been working for land owners and for tenants, not within the State of New Jersey in connection with their leases, but in the tax aspects of any leasing transactions.

One relevant piece of information may be that my firm, and myself in particular, as to the tax aspects, represented the State of New Jersey about a year ago in connection with some safe harbor leasing for the--

ASSEMBLYMAN FLYNN: Safe what?

MR. LEVITT: Safe harbor leasing for New Jersey Transit, and the transaction where they sold and leased back some rolling stock to the Lipton Company.

ASSEMBLYMAN GILL: That is equipment, not land.

MR. LEVITT: No, but my expertise is in the tax area, and that is what Speaker Karcher had asked me to come and talk to you about.

ASSEMBLYMAN FLYNN: The purpose of your being here, as I understand it, is to tell us what tax benefits accrue from real estate transactions. Is that right?

MR. LEVITT: Yes, sir.

ASSEMBLYMAN FLYNN: That is basically the scope of his testimony, not to delve into any specific sites or that sort of thing.

ASSEMBLYMAN HENDRICKSON: Regarding the tax benefits that accrue, wouldn't you say that depending on the investor himself and his income and what he is actually looking for, that that would all be part of that?

MR. LEVITT: When you say the investor, do you mean the land owner?

ASSEMBLYMAN HENDRICKSON: The investor would be the actual owner/operator.

MR. LEVITT: Absolutely. I agree.

ASSEMBLYMAN HENDRICKSON: And, that each investor may have to, for one reason or another, have different requests on his percentage of return.

MR. LEVITT: Clearly. I think the parameters are set by what is available in the marketplace, and what more or less becomes the market rent.

ASSEMBLYMAN HENDRICKSON: The market is basically what would be the ultimate.

MR. LEVITT: I believe that is correct.

ASSEMBLYMAN FLYNN: Tell us, in a real estate transaction where a landlord owns the property and the State leases the property, what tax benefits accrue at both State and Federal levels.

MR. LEVITT: I think to put this in perspective, you should understand that my experience is that the tax benefits are probably one

of four different avenues that a land owner is looking for -- his benefits, his return.

Number one, obviously, is the cash flow from the property. Number two, before he gets any cash flow, part of the income on the property is being used to amortize and pay off the principal of the debt. The reduction of the debt is clearly a benefit. Number three would be the increase in the value of the property over the time that he holds it, which you might refer to simply as the inflation aspect. The fourth part are the tax benefits.

Tax benefits are clearly quantifiable, clearly salable, and clearly worth something as evidenced by the New Jersey Transit transactions over the last few years, which I referred to earlier, where they are selling only tax benefits. People are paying dearly for these tax benefits.

There are two types of tax benefits if we break them down. They can be broken down into roughly what you can call deductions and what you can call credits. For deductions, the mechanism is simply, if I have a dollar of deduction and depending on my bracket -- for our example purposes, assume I am in the highest marginal bracket of 50%. If you give me a dollar of tax losses, that is going to save me or reduce my tax liability by 50 cents.

Credits, on the other hand, are a simple offset against what would otherwise have been my liability to the Federal government, and in some instances to the State government.

Deductions can be further broken down into items which are immediately deductible -- utilities, maintenance and repairs -- immediate deduction in the year incurred or paid, depending on your accounting method. There are other deductions which have to be capitalized and written off over a specified period of years.

Buildings, for instance, under the new rules since 1981, can be depreciated over fifteen years. Air conditioning equipment, which is a principal piece in what we are talking about, has a five-year write-off period. Some other furnishings might be five years.

The credit mechanism, the investment credit, is a pure reduction in the cost of what that property cost you. For instance, in

the case of the air conditioner in the subject lease, if the air conditioner cost \$7500, and I'm not trying to pick the numbers out of here just by close example -- if it cost \$7500, there would be a \$750 investment credit available to the owner of that piece of equipment. That \$750 would be to his benefit to the extent that he could offset his other tax liability. It does not have to be the tax liability that flows out of this lease. It can be any tax liability that he has.

ASSEMBLYMAN FLYNN: Is that over and above his annual depreciation of the five years?

MR. LEVITT: Yes, over and above his depreciation. The way the mechanics work, Mr. Flynn, is that to the extent that you claim depreciation of an investment credit of \$750, it reduces the amount that you are allowed to claim as depreciation by 50%. So if it cost him \$7500, he would have to take \$375 off the \$7500 number, and then claim whatever the balance is -- \$7100 plus, as depreciation over the remaining five years.

ASSEMBLYMAN FLYNN: All right, we'll use that as a good hypothetical example -- a \$7500 air conditioner, with a five-year write-off. Is that right?

MR. LEVITT: Yes.

ASSEMBLYMAN FLYNN: What does that translate into in terms of a benefit to a landlord?

MR. LEVITT: There are two elements. Number one, there is an investment credit of \$750. Number two, there is rough \$3600 of tax savings, assuming a 50% taxpayer, but \$3600 in tax savings over the five-year write-off period, plus \$750 during year one as a credit, is \$4350.

ASSEMBLYMAN FLYNN: But, if the State in its leases for renovations is paying for the air conditioning unit dollar for dollar, do you think that that practice should change?

MR. LEVITT: Yes, I do.

ASSEMBLYMAN FLYNN: What factor do you think the State should plug in in terms of the tax benefit to the landlord using the air conditioner as our hypothetical example? Should the State ask for the whole \$4200 or \$4300 back or off of the total \$7500 hypothetical price, or should it ask for half or three-quarters of it back?

MR. LEVITT: This is a function of negotiation.

ASSEMBLYMAN FLYNN: All right, but what would be a fair-- You know, you're saying that one day you're negotiating for a landlord and one day you're doing it for a tenant. What would you deem to be a fair factor?

MR. LEVITT: I guess neither of the extremes would be viewed as fair, but some place in the middle. Frankly, when negotiating these transactions, fairness plays a role, but one is always attempting to negotiate the best possible deal for whichever side of the fence he is on at that moment.

The part where I think I can help you most is exactly in the improvement area that is part of this lease. Let me address the main part of the lease and set that aside quickly.

The depreciation on the building is clearly a function in what an owner would like to get as a return on the building. There is absolutely no question in my mind that he is looking to all four features that I mentioned earlier.

What becomes an overriding factor will probably be what has surfaced in the marketplace as a fair rate of return. For example, there are many landowners at this point who would be very content to be able to get what is referred to as a 14% cash-on-cash return on real estate. If they put in \$100,000 of cash, they would like to see \$14,000 a year of cash return.

I assume that that 14% number has already consumed the benefits of depreciation, appreciation, and amortization, and that is kind of a benchmark, so I think we can sum up on the actual part of the building by simply saying what your previous witness had to say in terms of market value of a piece of real estate, and that is where you should be focusing.

The improvements present quite another problem. What you have got in the lease that Speaker Karcher outlined to me is a situation, and I'll use round numbers rather than specific numbers -- you've got a situation where roughly \$20,000 of improvements are going into this lease. The State is paying back the \$20,000, plus 18% interest over a five-year period. In essence, what I believe has happened from the point of view of the landlord, the real estate owner, is that on his \$20,000 investment, he can be viewed to be receiving 18%

interest, plus 50%. The 50% is the element of the tax savings that appears to be completely ignored in this lease arrangement.

Let me go back and see if I can explain that in terms of what I said earlier. The \$20,000 that went in is going to be written off entirely over that five-year period at different times. Some of it will be written off entirely up front, some of it will be written off rateably over five years, and some of it will not be written off rateably over five years. But, by the end of that five-year period, the entire \$20,000 will be claimed as a tax deduction. Assuming 50% tax brackets for the landowner, that \$20,000 is going to save him \$10,000 in income tax.

That is what I meant when I said that he got his money back of \$20,000, plus the 18% interest that is stated, plus 50%. That, in my view, is a pretty good return. That totally ignores, and from a point of view of conservatism, the investment credit, which I'll come back to in a second and show you how I think that plays into this lease. It also totally ignore salvage value that might exist at the end of the five years.

ASSEMBLYMAN FLYNN: What do you mean by salvage value?

MR. LEVITT: Salvage value can be viewed as what the value of those improvements are at the end of five years. Probably the correct way to factor it in, and this involves a little bit of crystal balling -- of the \$20,000, you should probably subtract from it what you think those improvements will be worth at the end of the term, because really he hasn't spent it. Then apply the formula I described to you. The 50% would then apply to whatever the net cost is over the five years.

Focus, if you will, on the investment credit aspects of this transaction, and the one that comes easiest to mind in this one, although everything I'm saying to you should be viewed across the board in all leases-- If you've got a \$7500 air conditioner that has \$750 of investment credit -- in other words, the credit that the landowner gets back when he files that first-year's tax return -- the State is not only paying back the \$750, which he already got from the Federal government, but the State is paying 18% interest on that \$750. So, in essence, what it appears to me has happened is, the landlord isn't really out the \$750, but yet, the State is paying him back \$750, plus interest.



As I mentioned earlier, these are points that are all the way over here. I believe your lease is all the way over on the left. The real world being what it is, a negotiation will not result, in my experience, on either the far right or the far left. For instance, the landlord could rightfully say to you, "Well, I don't get tax benefits at a 50% rate." He could say this for whatever reason -- whether he has reduced his income through other means or he just doesn't have enough income to be in a 50% bracket. That is certainly a valid point that he can make to you, and what is certainly a valid point is just the straight negotiation of what one thinks he should be getting.

ASSEMBLYMAN GILL: Mr. Levitt, could you add to that the possibility of double depreciation of the IRS that we talked about in the past?

MR. LEVITT: Are you referring to the double-declining balance?

ASSEMBLYMAN GILL: Yes.

MR. LEVITT: The double-declining balance is a method for depreciating personal property on an accelerated basis. In other words, by comparison, a straight line would be if I took \$5000 over five years, I would take it rateably at \$1000 per year. Double-declining balance would result in a front loading, if you will, of the depreciation deductions. Instead of winding up with the straight line of \$1000, you might wind up with \$2500 during year one and come down on a curve, and by the fifth year, you might only have deductions of \$200. It is a method of front loading depreciation deductions in which the Internal Revenue code is really the example of how the use of money is a factor in the real world. A dollar today is certainly worth a lot more than a dollar you are going to give me five years from now, and the double-declining balance of front loading depreciation is a perfect illustration of how that works, because your deductions comes out sooner.

ASSEMBLYMAN HENDRICKSON: Could I ask you a question on that? Won't that come out perhaps a little uneven at the time of sale or on the reciprocal on a band of investment? At times it does catch up, and most times it catches up on an escalated--

MR. LEVITT: What happens in, and what I'll refer to it as the turnaround -- if I'm depreciating an item over its life, over what might be viewed as its taxable life, I'm getting ordinary deductions over that period. When I sell the property, I've got to pay a gain, but that gain, hopefully, as a tax lawyer, I would like to see that gain come back as capital gain. Notwithstanding the character, it is a turnaround. If you assume, as I did for purposes of conservatism, that the improvements do depreciate the full \$20,000 -- if you'll recall, I did not put in any salvage or residual value -- assume they are worthless at the end of five years, and they may be worthless because their useful life is gone, or they may be worthless because they only had a value to the State of New Jersey as a Motor Vehicle agency, and when a new tenant comes in, they are valueless. But, assume they are worthless at the end of the five years. In that case, if you sell or dispose of them, you have no proceeds. When you have no proceeds, there is not so-called turnaround in terms of the give back of the tax benefits. The contra to that is, if you suspect that there will be value at the end of the lease term, then that value is the same element which I suggested as salvage value or residual value, which ought to come into the equation up front.

Another element, and I think the State is correct in this situation -- I'm not sure why the State did it, but I would like to comment on it. Why are the improvements part of the lease and not simply bought and paid for and let out for bid by the State of New Jersey? I don't know what the motivation to that is. I suspect the motivation is not what I'm going to suggest to you. By letting the landlord own these improvements, build them for you, and build them into the lease, you should be able to accomplish a reduction in the cost. Specifically, if the State spent \$20,000 for these improvements, it is \$20,000. There is no tax affecting it. The State pays no tax; it is \$20,000 before tax, and it is \$20,000 after tax.

On the other hand, if this were done by the landlord, that \$20,000, and I'm coming full circle back to where I was before -- that \$20,000 is before tax, and on an after-tax basis, it is \$10,000. The State should be paying for the lease on the basis of a \$10,000 expenditure by the landlord, not a \$20,000 expenditure, which is the after-tax cost.

ASSEMBLYMAN HENDRICKSON: Can I expand on that? Mr. Chairman, if I may? We just brought up special use. Would special use come into this also? There are certain needs for the present use, for the best use, at the time of that building. Doesn't that all come into part of that?

MR. LEVITT: Are you referring to the parking that you were discussing earlier?

ASSEMBLYMAN HENDRICKSON: No, I am specifically referring to the air conditioning because of the need, and as has been brought up before by Assemblyman Kavanaugh, over the years we have all heard how terrible it is to try to do business with the State in their Motor Vehicle agencies -- the long lines, the dull lights. There is no lighting. I could go on and on, but I don't want to take the time to discuss the problems with that. But, we're trying to turn some of that around. Would that be an influence?

MR. LEVITT: It would be an influence. I'm not opposed to putting in a large air conditioner. If the decision is, and it is not a tax rule that is going to dictate how you improve this facility, there are going to be lots of other reasons, but it won't be the tax motivation at all.

Tax analysis is, in a sense, very simple. After the rest of the folks come back and say, "Here is what we are going to spend," the tax lawyer can then sit, and he doesn't even have to go to visit the site. It is a very impersonal type of transaction. It is simply knowing the tax law and being able to analyze it, and then negotiating the best deal. I think the answer to your question is, the highest and best use comes in in terms of what the price is going to be and what you decide you want to put into it.

ASSEMBLYMAN HENDRICKSON: And what the needs are.

MR. LEVITT: And the needs. That is a give-in in terms of what the tax lawyer or tax accountant can then react to.

ASSEMBLYMAN HENDRICKSON: Thank you.

ASSEMBLYMAN FLYNN: Do you have anything else you would like to say regarding this area?

MR. LEVITT: I've covered most of my points.

ASSEMBLYMAN FLYNN: All right. We've got ten minutes for questions.

ASSEMBLYMAN KAVANAUGH: I would just like to ask this. Sir, you mentioned that you were invited down by Speaker Karcher today. Are you or your firm being reimbursed for your testimony here today?

MR. LEVITT: No, we're not.

ASSEMBLYMAN KAVANAUGH: It is great that we have citizens who want to perform.

ASSEMBLYMAN FLYNN: Do you have a question, Assemblyman?

ASSEMBLYMAN GILL: I have just one question, Steven. Regarding the bottom line of everything you are saying, it would appear to me that a new look is needed at the rentals and leases by the State. I don't mean just Motor Vehicle agencies, but the whole operation. I have taken into consideration some of the factors you brought up -- double leasing, etc., etc.. Is this pretty much what you are saying?

MR. LEVITT: If the State is not considering the tax benefits, then I believe the State is not using a practice which is consistent with what goes on the business community. I think tax considerations are a very significant element of negotiating any business transaction.

ASSEMBLYMAN GILL: And, if we want to get an answer to it, we'll have to wait until we talk to somebody from the State to find out what the actual practice is. But, you're saying it is desirable.

MR. LEVITT: It is certainly desirable.

ASSEMBLYMAN FLYNN: Is there any advantage to the State in either leasing or owning its own Motor Vehicle agencies?

MR. LEVITT: Do you mean the physical facilities?

ASSEMBLYMAN FLYNN: Yes.

MR. LEVITT: I assume--

ASSEMBLYMAN FLYNN: From your view, would it be better for the State to lease, but to lease with tax benefits and all that? Or, would it be better for the State to own?

MR. LEVITT: I think this goes to a question which is beyond my expertise. It deals with the cost of money to the State. If the State could buy the facility using dollars which cost them less money than the percentage that was built into the leasing cost, then I would certainly want to look at ownership. But, ownership also involves other intangibles that are not there when leasing.

ASSEMBLYMAN FLYNN: All right. Are there any other questions?

ASSEMBLYMAN HENDRICKSON: I have one question. What would the standard business practice be on a situation where the State would lease for five years? Should there be a renewal option in the first year's lease?

MR. LEVITT: I would expect so.

ASSEMBLYMAN HENDRICKSON: What did you say?

MR. LEVITT: I was surprised not to see a renewal provision.

ASSEMBLYMAN FLYNN: In the first five years, the State would have paid about-- Well, we'll take the one example that we have in front of us -- \$21,000 directly to the landlord and another \$5600 directly for cabinets. That is about \$27,000 which would be paid during the five-year period. Would that be kind of an overload during that first five years with no negotiated option clause?

MR. LEVITT: It would appear to be, and as I understand the facts, the \$5600 counter is now owned by the State once they pay for it.

ASSEMBLYMAN FLYNN: The State owns the counters.

MR. LEVITT: The counter is outside of any other points. Presumably, if the State stayed there, or left the premises, they could do whatever they wanted with the counter.

But, as to the balance of the \$20,000 of improvements, it would certainly be in the best interest of the State to have negotiated some sort of renewal option in which we would not be paying again for that \$20,000. You have certainly paid for it once.

ASSEMBLYMAN FLYNN: And, the rent should then drop during the second five-year period.

MR. LEVITT: I would expect to see that the rent factor for the second five-year period would ignore the \$5.11 factor which is attributable to the \$20,000 worth of improvements.

Incidentally, I did a calculation which shows that if you assume a 50% tax benefit on the actual \$20,000, and again, using the 18% rate and a five-year term, that instead of paying \$5.11 per square foot for the improvements as factored into the lease, on the other extreme it could be viewed as \$2.50.

ASSEMBLYMAN ZIMMER: That wouldn't didn't discount the value of the tax deduction over time.

MR. LEVITT: That would not give you a present value of the tax deduction, but it would recognize that it was a \$10,000 expenditure and not a \$20,000 expenditure.

ASSEMBLYMAN ZIMMER: So, that would an open (inaudible) on the lessee's part, but he would have to expect to negotiate it up.

MR. LEVITT: That is right. And then I guess you come to the broader question of what is fair.

ASSEMBLYMAN FLYNN: All right, if there are no further questions--

ASSEMBLYMAN HENDRICKSON: I think what you have brought to us is that the State over the years has not really developed a leasing practice to meet today's market.

ASSEMBLYMAN FLYNN: I don't know if we can say that yet, John. I wouldn't want to say that. He doesn't know.

MR. LEVITT: I don't know. I'm reacting to the one set of facts. If this set of facts is representative, then I agree with you.

ASSEMBLYMAN HENDRICKSON: But, you do agree with me.

ASSEMBLYMAN FLYNN: What he is saying is, if we're not taking tax benefits into account, then we should get into the twenty-first century. We may be; I don't know. We're going to hear from the State's people probably on Monday, because it looks like it is getting late today. We'll find out if they take that into consideration. I don't want to castigate our people yet.

ASSEMBLYMAN HENDRICKSON: Oh, I didn't mean to castigate. That was nothing. When I talked to him as an expert--

ASSEMBLYMAN FLYNN: He is saying that we should do it.

ASSEMBLYMAN HENDRICKSON: (continuing) because our past practices are bad. That is all I'm trying to say.

MR. LEVITT: I'm saying that you should do it. I have no knowledge of what the State is doing, other than the facts of this one particular lease in Matawan.

ASSEMBLYMAN FLYNN: I want to thank you very much for taking your time to come and give us an enlightenment. We are going to

continue this hearing on Monday at ten o'clock. Can everybody get here at ten o'clock, because we've got a lot to cover? We've got a lot of witness on Monday. It is a very good area, and I think we are making progress. I would like to ask everybody to bring your folders with you, and I would like to ask the witnesses who didn't get a chance to testify today to come in on Monday at ten o'clock sharp. We are going to start at ten o'clock sharp, regardless of how many Committee members are here, because I think we've got a lot of area to cover, and we want to get it done before June is over.

(Hearing concluded)