

League of Municipalities

Tax Exemptions:

What to Know Before Taking Flight

What is a Pilot?

Payment In Lieu Of Taxes - N.J.S.A. 40A:20-12(b).

“During the Term... in lieu of any taxes to be paid on buildings and improvements... and to the extent authorized... on land, the URE shall make payment to the municipality of an annual service charge, which shall remit a portion of the revenue to the county...” In addition, the municipality may assess an administrative fee not to exceed 2% of annual service charge.

What does “In lieu of any taxes” actually mean?

- It means land and improvements are listed on municipal tax roles as exempt from taxation for the period in the tax exemption. *N.J.S.A. 40A:20-12*
- PILOT payment is made to the municipality and it is not shared by the municipality with the county and board of education in the same way that traditional ad valorem taxes are shared.
- Exemption allowed when clerk certifies to tax assessor that a financial agreement has been entered by the municipality.
- Deliver to tax assessor certified ordinance and financial agreement.

How is a PILOT memorialized? N.J.S.A. 40A:20-9

- A financial agreement is entered into between the municipality and the qualified entity.

How does a municipality enter into a Financial Agreement? N.J.S.A. 40A:20-9

A Financial Agreement must be approved by ordinance of the municipality

- Same for subsequent amendments.
- Same for transfers / assignments.

What can the term of a PILOT be? N.J.S.A. 40A:20-12(a)

- A financial agreement may specify duration of up to 30 years from completion but not more than 35 years from signing of a financial agreement.

NOTE: The term of the exemption can be less than 30 years.

10 yrs, 15 yrs , or 20 yrs - depending upon the municipality and the market.

Example

**Any Project Urban
Renewal, LLC
Municipal Revenue
Comparison
Conventional Property
Taxes
And
Tax Abatement Program**

CONVENTIONAL PROPERTY TAXES – 458 Residential Rental Units, 535 Parking Spaces, 20,000 sq. ft. of Commercial Space

Gross Income		\$10,465,219
Vacancy Adjustment	5.00%	\$523,261
Operating Expense Adjust.	27.00%	\$2,825,609
Net Income		\$7,116,349
Market Valuation	10.13% Cap Rate	\$70,250,237
Assessed Valuation	50.51% Assess. Ratio	\$35,483,395
Tax Liability	4.606% Tax Rate	\$1,634,365
Distribution of Taxes:		
County Tax	1.197%	\$424,736
County Open Space Tax	0.021%	\$7,452
District School Tax	1.354%	\$480,445
Local School Tax	0.109%	\$38,677
Municipal Purpose Tax	1.925%	\$683,055
Total =>	4.606%	\$1,634,365

City Share of Taxes (1.925% is 42% of 4.606%)	42%	\$683,055
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TAX ABATEMENT PROGRAM – 10% Gross Revenue

Gross Revenue		\$10,465,219
Vacancy Adjustment	5.00%	\$523,261
Adjusted Gross Revenue		\$9,941,958
Annual Service Charge		\$994,195
Annual Administration Fee	2.0%	\$19,883
Total Annual Payment to City		\$1,014,079

City Share of Annual Service Charge	95%	\$944,485.25
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Summary:

5% of ASC goes to County = \$49,709.75

Project renders \$261,431.00 more annually to City under the tax abatement program.

What does “to the extent authorized... on land” mean?

- Land taxes exempt for housing projects. N.J.S.A. 40A:20-12.
- Land taxes cannot be exempt for retail, commercial, office, industrial.
- *N.J.S.A. 40A:20-12.*
- If the land taxes are not exempt then the entity must pay them as billed by the municipality.
- However, once paid by the entity the land taxes are credited against the entity’s annual service charge payment. N.J.S.A. 40A:20-12(b)(2).

NOTE: If the land taxes are not exempt under the tax exemption, they remain traditional ad valorem taxes.

Thus, they continue to be shared by the municipality with the county, board of education, and etc..

What is an “annual service charge” (ASC)?

- A percentage of annual gross revenue (AGR) generated by the Project.
- Not less than 10% of AGR for market rate projects.
- Not more than 15% of AGR for low or moderate income housing

OR

- Not less than 2% of the Total Project Cost for market rate projects.
- Not more than 2% for low or moderate income housing

NOTE: 2% of TPC formula usually reserved for office retail industrial, possibly “for sale” affordable housing.

NOTE: a tax exemption can have a schedule where the ASC increases over the term of the exemption.

NOTE: a tax exemption can have different ASC for different types of uses (i.e. projects that have market rate and affordable housing units).

What is annual gross revenue?

- Annual gross rent and other income of the entity. N.J.S.A. 4A:20-3(a).
- Includes rent, insurance, operating and maintenance expenses paid for by a tenant which are ordinarily paid for by a landlord. N.J.S.A. 4A:20-3(a).

NOTE: General Rule: It Includes apartment rent, retail or commercial space rent, parking space rent, revenue from washer/dryer etc.

NOTE: It does not include certain subsidies from government for certain types of affordable housing projects.

NOTE: It does not include any gain on the sale of a condo unit.

When an entity and municipality limit gross revenue the financial agreement they do so at the risk of violating the statute.

What is annual gross revenue in a “for sale” Project? N.J.S.A. 40A:20-14(a)

Components:

- Deed Price
- Common Expense Assessment on Unit
- Impute Interest Rate
- Presume 100% financing for term of tax exemption

Note: upon a sale of a condominium unit at a higher price municipality may increase the annual service charge using the new deed price.

Note: if the unit decreases in value, the service charge will never go below the initial assessed value for the unit.

Note: if certain condominium units in the project are not sold, a tax assessor shall establish the service charge by determining the initial assessed value for the unit.

Note: For residential condominium units, the governing body may, by resolution, suspend or increase the annual service charge on the unit if the unit owner moved out and leases the unit to a tenant. NJSA 40A : 20-14

What is Total Project Cost?

Estimated Total Project Cost Calculation per N.J.S.A. 40A:20-3(h)

A. Cost of land and improvements to Urban Renewal Entity	\$30,240,000
B. Architects, Engineers, surveying and Attorney Fees (paid or payable) in connection with the planning, construction and financing of the Project	\$5,876,497
C. Projected construction cost per architect's estimate	\$114,471,134
D. Insurance, Interest, and Finance Costs during Construction	\$16,188,882
E. Cost of Obtaining Initial Permanent Financing	\$2,501,000
F. Marketing and other expenses payable in connection with initial lease of units	\$250,000
G. Real Estate Taxes and Assessments during Construction Period	\$249,350
H. Developer's Overhead based on a percentage of (c) above, to be computed in accordance with percentage given in law N.J.S.A. 40A:20-3 (h)	\$5,723,557
Total Project Cost	\$175,500,420

NOTE: N.J.S.A. 40A:20-8(c) requires "a statement prepared by a qualified architect or engineer of the estimated cost of the proposed project". This is presumed to mean the construction cost - see C. above

Projected construction cost per architect's estimate

EXHIBIT C-1

WAVE URBAN RENEWAL LLC

Certification of Estimated Construction Costs

On this _____ day of November, 2018, the undersigned being the architect for the Project, does hereby certify to the best of my knowledge and based upon estimates provided by Wave Urban Renewal LLC, that Item C of Exhibit C accurately reflects the estimated construction costs of the Project.

By: _____ Architecture and
Engineering, LLC

Name: _____, AIA

What are mandatory staged adjustments? N.J.S.A. 40A:20-12(b)(2)

- 1st Stage: = ASC for a time not less than 6 years, not more than 15 years

NOTE: This stage allows for project stabilization.

- 2nd Stage: Greater of ASC or 20% of what conventional taxes on land and improvements would otherwise be for a time period not less than 1 year, and not more than 6 years.

- 3rd Stage: 40%
- 4th Stage: 60%
- 5th Stage: 80%

NOTE: This stage allows for the project to gradually pay charges that are comparable to conventional ad valorem taxes.

NOTE: a financial agreement must have all 5 stages.

NOTE: *Conventional tax assessment principles collide with ASC principles.*

Tax Assessor and URE should cooperate during the term of the tax exemption to make sure that the tax assessment on the books (land and improvement) is

accurate to avoid disputes on the ASC when staged adjustments go into effect.

NOTE: The entity is still paying a PILOT payment, not conventional taxes!

What is a minimum annual service charge (MASC)?

The total taxes levied against the property in the last full year in which the property subject to taxation.

The entity pays the MASC in any year that the MASC is higher than ASC.

N.J.S.A. 40A:20-12(b)(2).

What can the term of a PILOT be? *N.J.S.A. 40A:20-12(a)*

A financial agreement may specify duration of up to 30 years from completion but not more than 35 years from signing of a financial agreement.

NOTE: The term of the exemption can be less than 30 years.

10 yrs, 15 yrs , or 20 yrs - depending upon the municipality and the market.

How is a PILOT memorialized?

A financial agreement is entered into between the municipality and a developer.

N.J.S.A. 40A:20-9.

When does a project qualify for a long term tax exemption?

N.J.S.A. 40A: 20-4

1. A project is in a redevelopment plan that has been adopted under the Local Redevelopment and Housing Law. (N.J.S.A. 40A:12-1 et seq.) .
2. A project is necessary, useful, or convenient for the relocation of residents to be displaced by redevelopment in a redevelopment plan.
3. A low income housing project even if it is not in a redevelopment plan.
4. A moderate-income housing project even if it is not in a redevelopment plan.
5. A project is in an Urban Enterprise Zone where such zone has been designated as such under the New Jersey Urban Enterprise Zone Act (N.J.S.A. 52:27H-60). See Local Redevelopment and Housing Law (N.J.S.A. 40A:12-5(g)).

When Does a Project not qualify for a Long Term Tax Exemption?

1. A project is not in any of the categories above; and
2. A project that is in an area that has been determined to be in need of “rehabilitation” under Local Redevelopment and Housing Law (N.J.S.A. 40A:12-1 et seq.), but where no redevelopment plan has been adopted.

NOTE: Such a project duly qualifies for a 5 year tax abatement under the Five Year Tax Exemption and Abatement Law (N.J.S.A. 40A:21-1 et seq.)

How does a Company qualify for a long term tax exemption?

N.J.S.A. 40A:20-5

- State “Urban Renewal” in name.
- Purpose stated: operate under LTTEL.
- No business other than the Project.
- Purpose Stated: operations directed toward redevelopment and associated activities; low-moderate income housing.
- Limitation on transfer of project.
- Make ownership disclosures.
- Limitation on profits.
- crisis management by municipality and NJ Dept. of Com. Affairs.

NOTE: Corp., LLC, LP and Partnership OK - Unincorporated entity; however, it must file a trade name certificate with the County Clerk’s office.

NOTE: An out of State entity may qualify to be an urban renewal entity in New Jersey.

How does a company qualify as an urban renewal entity?

1. File original the company organizational certificates and an original Dept. of Community Affairs disclosure certificates with Dept. of Community Affairs in Trenton.
2. Company organizational certificate must have all of the language in it that is required by NJSA 40A:20-5(a) thru (g). Language must be recited word for word.
3. If approved, DCA issues a Certificate of Approval and returns original company organizational certificates to the applicant.
4. Applicant must file the company organization certificate with the Certificate of Approval with the Secretary of State. If the entity is to be an unincorporated entity it must file a trade name certificate with the Certificate of Approval in the County Clerk's office.

NOTE: The NJ Secretary of State will reject the filing if the Certificate of Approval is not attached.

What powers does an urban renewal entity have?

Same powers as any other duly formed corporation, partnership, limited liability company, etc. N.J.S.A. 40A:20-6 and 7.

When must a qualified urban renewal entity apply to a municipality for a long term tax exemption for a project?

Before proceeding with any projects (N.J.S.A. 40A:20-8).

What does “before proceeding” mean

Before commencement of work on a Project.

NOTE: Environmental remediation & demolition = site preparation, not construction. (This rule is not followed by all municipalities)

After receipt of any required subdivision and/or site plan approval is granted to a project by the municipality’s planning board?

NOTE: (This rule is not followed by all municipalities).

What must a qualified urban renewal entity do to apply for a long term tax exemption?

N.J.S.A. 40A:20-4: “acquire by purchase or lease for not less that the term...”

It must:

- be a contract purchaser of land or land and improvements in the redevelopment plan;
- own the land or land and improvements;
- be lessee of land and /or improvements with a lease term that is longer than the tax exemption applied for;
- make written application to the municipality for approval of an exemption in a form required by a municipality.
- have an agreement with the municipality or its redevelopment entity to redevelop land in the redevelopment plan area

What must be in the entity's tax exemption application?

See N.J.S.A. 40A:20-8(a) through (f) as follows:

- (a) A general statement of the nature of the project.
- (b) A description of the project area, description of units in the project.
- (c) Set forth the architectural and site plans as required.
- (d) A statement of architect or engineer for the estimated cost of the project.
- (e) Source, method and amount of money to be invested in the project by the applicant or others.
- (f) A fiscal plan with:
 - estimate of AGR;
 - estimate of expenses;
 - estimate of interest and debt service;
 - estimate of reserves; and
 - estimate of payments to municipality if tax exemption granted.

Applicant must certify to:

- accuracy of facts and data in application;
- project conforms to municipal ordinances;
- project complies with redevelopment plan requirements;
- project complied with municipality's master plan;
- if low or moderate income units, a statement that they will be restricted in occupancy to only qualified occupants.

ESTIMATED FISCAL PLAN

Rental Income:

	<u>Units</u>	<u>Annual</u>
Apartments		
Studio Units x	43	\$1,377,982
One Bedroom Units x	132	\$5,021,339
Two Bedroom Units x	121	\$6,028,787
Three Bedroom Units x	32	\$2,002,644
Four Bedroom Units x	8	<u>\$ 727,938</u>
Total Potential Residential Income		\$15,158,690
Retail Income		\$ 852,142
Other Income (Amenity Fees, etc.)		\$ 284,953
Parking Income		\$ 317,338
Total Gross Income		\$16,613,123
Vacancy (5%)		<u>\$ (830,656)</u>
Effective Gross Income		\$15,782,467

Property, administrative and financial expenses:

Payment in lieu of real estate taxes - 12% + 0.7%	\$2,004,373
Management Fee (3%)	\$ 473,474
Professional Fees	\$ 136,668
Repairs and Maintenance	\$ 535,592
Insurance	\$ 392,160
Utilities	\$ 406,311
Labor - Payroll, Taxes & Benefits	\$ 559,884
Advertising/Marketing	\$ 73,875
General & Administrative Expenses	\$ 36,937
Reserves	<u>\$ 84,000</u>
Total Expenses	\$4,703,274

Net Operating Income (before Debt Service): **\$11, 079,193**

Debt Service (4.6% int on term incl amortization) \$8,863,354

NET OPERATING INCOME LESS DEBT SERVICE: **\$2,215,839**

EXHIBIT B-3
WAVE URBAN RENEWAL LLC

ANNUAL GROSS REVENUE COMPUTATION

(1)	Total Annual Gross Rental Income	\$15,782,467
(2)	Real Estate Taxes and/or Assessment on Property*	\$ 0
(3)	Insurance Premiums*	\$ 0
(4)	Operating, Maintenance or Repair Expenses*	\$ 0

*NJSA 40A:20-3(a) provides that “the financial agreement shall establish the method of computing gross revenue for the entity, and the method of determining insurance, operating and maintenance expenses paid by a tenant which are ordinarily paid by a landlord, which shall be included in gross revenue...”

Total Annual Gross Rental

	<u>Units</u>	<u>Annual</u>
Apartments		
Studio Units x	43	\$1,377,982
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Annual Payment in Lieu of Taxes:

12.00%	Years 1-12	\$1,893,896.00
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Where does the applicant file its tax exemption application?

Application shall be addressed to and filed with:

“The Mayor or other Chief Executive Officer” for the municipality N.J.S.A. 40A:20-8.

What is the mayor required to do with the application?

“Mayor ... shall within 60 days of receipt... submit the application with a recommendation to the Municipal governing body.” N.J.S.A. 40A:20-8.

NOTE: referring to a complete application.

NOTE: mayor may send application for comment and advice to:

- Law Department.
- BA
- CFO / Chief of Staff
- Tax Assessor
- Tax Collector
- Financial Consultant
- Others
- Member of governing body

NOTE: Administration can negotiate terms of the tax exemption applied for during 60 day period.

How does a governing body approve or disapprove an application?

By Resolution

NOTE:

Governing body can continue negotiation

Member of governing body may state why they are voting to disapprove when they vote.

Application can be re-submitted by the entity with or without changes.

N.J.S.A. 40A:20-8.

NOTE: Difference between procedures for Application and Financial Agreement

What must be in a Financial Agreement?

The municipalities' determination as to:

- (a) relative benefits to the project or redevelopment area when compared to costs
- (b) statement of importance of granting to obtain development & impact locational decisions of probable occupancy.

N.J.S.A. 40A:20-11

NOTE: The above findings are usually set forth in the authorizing ordinance and repeated in the FA.

- Land and/or improvements
- Entity to file an annual audited financial statement with net profit calculation with Mayor and governing body.
- Permit municipality to inspect project and entity's books and records.
- dispute resolution
- termination provision
- method of computing gross revenue
- estimated TPC
- detailed representations re: use, operation, management of project
- 2% administrative fee
- term
- ASC formula
- consent to transfer provisions
- county fee
- transfer admin. fee of 2% of ASC

What are excess profits?

N.J.S.A. 40A:20-15

Whenever the “**net profits**” of the entity for the period (taken as one accounting period commencing upon completion and terminating at the end of the last fiscal year) same exceeds the “**allowable net profits**” for the period... the Entity shall pay the “excess net profits” to the municipality.

What is net profit?

N.J.S.A. 40A:20-3(c)

The gross revenue of the Entity less all operating and non-operating expenses determined in accordance with GAAP

But:

See list of expenses included in N.J.S.A. 40A:20-3(c) (1) and

See list of expenses excluded in N.J.S.A. 40A20-3(c) (2).

What are allowable Net Profits?

N.J.S.A. 40A:20-3(b)

Take the **allowable profit rate** and apply it to the “Total Project Cost.”

What is the Allowable Profit Rate?

N.J.S.A. 40A:20-(b)

Use the greater of 12% or the Entity’s permanent mortgage rate plus 1.25%

Does a URE have reporting obligations?

Annual Audit Financial Statement

N.J.S.A. 40A:20-3 (c)

The Entity shall provide to the municipality within 90 days of end of Entity's fiscal year, an annual audited financial statement prepared by a certified public accountant, which clearly identifies the calculation of net profit of the entity.

Total Project Cost Audit

N.J.S.A. 40A:20-3(h)

- This audit goes hand in hand with the AFS.

Annual Disclosure Statement.

N.J.S.A. 40A:20-5(e)

- The URE is required to file an annual statement of the persons having an ownership

In the project and the extent of their ownership.

- Filed with the governing body.

What is a Financial Agreement?

A Contract.

So then what should be in a Financial Agreement?

- Standard contract provisions to protect municipality and entity.

NOTE: Municipal remedies upon default.

LTTEL does not contain a provision stating that PILOTS constitute a municipal charge under N.J.S.A. 54:4-66 or that City may proceed against entity under In Rem tax foreclosure Act - N.J.S.A. 54:5-1, et seq.

Financial Agreement must reserve to the municipality the right to in rem foreclosure for unpaid charges.

Can a project that has a tax exemption be sold?

Consent to transfer provisions:

- The URE shall not transfer more than 10% of the ownership of the project with the exception of a transfer to another duly qualified urban renewal entity. N.J.S.A. 40A:20-5(e)

The Financial Agreement may provide for:

- Assignment of a financial agreement can only be accomplished by municipal ordinance.
- Transferee must be a qualified URE and agree to assume obligations under the financial agreement. N.J.S.A. 40A:20-10(d)
- Municipality can levy a transfer fee equal to 2% of the ASC for the processing of a request to continue the tax exemption. N.J.S.A. 40A:20-10(d)

NOTE: Financial Agreement should state that assignment of a financial agreement provided that the URE is not in default under any aspect of the financial agreement. (ie: payment of all ASC and land taxes, have filed all annual audits and disclosure statements).

Special Considerations For The Transfer Of Condo Units

The Financial Agreement may provide that:

- The conveyance of a condo unit to a bona fide grantee does not require the consent of the governing body. N.J.S.A. 40A:20-14. It does not require a formal assignment of the financial agreement. The condo unit is subject to the financial agreement.
- Any gain realized by a URE on the sale of a condo unit is excluded from the calculation of gross revenue and net project (ie: no excess profit on the sale of a condo unit). N.J.S.A. 40A:20-3(a).
- Upon a re-sale the Tax Assessor is permitted to re-calculate the condo unit's ASC by using the purchase price set forth in the most recent deed. N.J.S.A. 40A:20-14
- For residential condo units, the governing body, may by resolution, suspend or increase the ASC on a unit if the unit owner moves out and leases the unit to a tenant. NJSA 40A:20-14

Can a URE terminate a Financial Agreement?

N.J.S.A. 40A:20-13

Yes, any time after the expiration of 1 year from the completion date of the Project.

How?

Notice to the governing body of the date it relinquishes its tax exempt status.

What Happens?

The Project is returned to conventional tax rolls. Tax Assessor employs use of added or omitted assessment principles.

Can a municipality require an entity to pay Affordable Housing Contributions in consideration for a PILOT?

- *N.J.S.A. 40A:12A-4.2* shall not exceed \$1,500.00 per market rate unit; \$1.50 per square foot for commercial; \$0.10 cents per square foot for industrial.

