MUNICIPAL PILOT AGREEMENTS IN NEW JERSEY

Presented by: Ronald H. Gordon, Esq of DeCotiis, Fitzpatrick & Cole, LLP
rgordon@decotiislaw.com
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WHY PILOT AGREEMENTS?

Attract private sector investment to

- Make improvements to property
- Locate a project in a distressed or blighted area

Enhance employment opportunities

Attract Residences
Lure commercial establishments

Develop vacant or underutilized properties

Intended to improve local conditions and spur economic development that otherwise would not occur

Potential benefits include additional short term and long term employment for local residents, attracting new businesses or improving existing businesses, luring new residents which may generate additional tax revenue, generate a tax revenue stream on once vacant or underdeveloped property, improve safety and increase adjacent property values
WHY PILOT AGREEMENTS?

- Without PILOTS many projects would not be built or would not succeed.
- Help meet the Constitutional obligation to provide Affordable Housing.
WHAT ARE PILOT AGREEMENTS?

- Long Term Tax Exemption ("LTTE") law - N.J.S.A 40A:20-1 et seq
- Term of Agreement:
  - Maximum - 30 years from completion of project or 35 years from date of financial agreement
  - Minimum - 10 years
- Designed to carry out the community development and rehabilitation goals of the Local Redevelopment and Housing Law ("LRHL") - N.J.S.A 40A:12A-1, et seq
- The financial agreement, which needs to be approved formally through the adoption of an Ordinance with all of the necessary procedural requirements for ordinance adoption EXEMPTS a project from taxation BUT requires a PAYMENT IN LIEU OF TAXES (PILOT) in an amount based generally on either
  - A percentage of REVENUE generated by the projects or
  - A percentage of TOTAL PROJECT COST
THE LONG TERM EXEMPTION

- Project MUST be consistent with the approved REDEVELOPMENT PLAN
- Requires the formation of an URBAN RENEWAL ENTITY that must be approved by Department of Community Affairs (DCA)
- Permitted and almost a NECESSITY for providing LOW and MODERATE INCOME (i.e. Affordable) HOUSING calculated by either method BUT limited to NOT MORE THAN 2% of project costs or not more than 15% of annual gross revenue
FIVE YEAR EXEMPTION AND ABATEMENT LAW

- **SHORT TERM** abatement generally used to reduce property tax payments for improvement to property
- Can be used to exclude all or a part of improvement values
- **ENABLING ORDINANCE** must be **SPECIFIC** as to **ELIGIBILITY REQUIREMENTS** which may include types of structures or improvements as well as qualifying GEOGRAPHIC AREAS or ZONES
Unlike long term tax exemption law there is very little room for MUNICIPAL DISCRETION in the award if the applicant meets the criteria of the statute and enabling Ordinance they are entitled to approval.

APPLICATION MUST INCLUDE:

- General description of the Project
- Plans demonstrating the structure of the Project
- Statement of the reasons for seeking the abatement
- Claimed benefits to be verified if the application is approved
- Statement of the taxes currently being assessed and taxes to be paid during the period of the abatement
HOW TO IMPLEMENT AGREEMENTS?

- **SUMMARY of LONG TERM TAX EXEMPTION LAW**
  - The following is a brief summary of the Long Term Tax Exemption Law (“LTTE”), N.J.S.A 40A:20-1 et. seq.
  - The LTTE allows for a maximum term of 30 years and a minimum term of 10 years for the length of the PILOT. The LTTE allows for two (2) methodologies for the determination of the annual service charge or PILOT payment:
    - A percentage of annual gross revenue (generally rent), not less than 10%
    - Percentage of total project cost, not less than 2%. These are discussed in more detail below.
HOW TO IMPLEMENT PILOT AGREEMENTS

- The property owner is obligated to pay real estate taxes on the land, however, is entitled to a credit against the subsequent year’s PILOT payment for the real estate taxes paid in the prior year.

- The municipality receives 95% of the PILOT payment and the County is entitled to 5% of the PILOT payment. The process of the LTTE requires the following actions:
  - **Formation of the Urban Renewal Entity:** The project must be owned or controlled by an Urban Renewal Entity ("URE"). The URE must be formed in accordance with N.J.S.A. 40A:20-5, which requires:
    - The name of the URE to contain the words “Urban Renewal”,
    - The Certificate of Formation state the public purpose for which URE is organized (i.e. construct projects for redevelopment)
    - Statement that the URE will engage in no other business other than ownership, operation and management of the project so long as financial agreement is in force;
    - Recitation of language contained in N.J.S.A 40A:20-5(d);
HOW TO IMPLEMENT PILOT AGREEMENTS

- Restriction on transfer or ownership interest in URE in accordance with N.J.S.A 40A:20-5(e) and annual disclosure of persons having an ownership interest in the URE;

- Statement acknowledging entity is subject to N.J.S.A 40A:12A-18

- The Department of Community Affairs (“DCA”) must approve the formation document before the Department of State will accept the filing of the Certificate of Formation by any URE.
HOW TO IMPLEMENT PILOT AGREEMENTS

- Submission of Application for PILOT: the developer must submit a written application to the municipality. The application must contain information required pursuant to N.J.S.A 40A:20-8
  - A general statement of the nature of the proposed project, that the project conforms to all applicable municipal ordinances, and that the project follows the redevelopment plan and municipality’s master plan, or in the case of a redevelopment relocation housing project, that it provides for the relocation of residents displaced from a redevelopment area, or, in the case of
  - A low and moderate income housing project, the housing units are restricted to occupation by low and moderate households.
  - A description of the project that outlines the area included and a description of each unit, as well as setting forth architectural and site plans.
  - A statement made by a qualified architect or engineer of the expected cost of the project, including the estimated cost of each individual unit.
SUBMISSION OF APPLICATION OF PILOT AGREEMENTS

- The source, method, and amount of money to be subscribed through the investment of private capital, setting forth the amount of stock or other securities to be issued or the extent of capital invested and the proprietary or ownership interest obtained in consideration therefore.

- A fiscal plan for the project that outlines schedules of annual gross revenue, the estimated expenditures for operation and maintenance, payments of interest, amortization of debt and reserves, and payments to the municipality to be made pursuant to a financial agreement that must be entered into with the municipality.

- A proposed financial agreement that conforms to the requirements set forth in the statute. The application must be addressed to the Mayor or Chief Executive Officer of the municipality, who must submit his recommendations to the municipal governing body within 60 days of receipt. The governing body must approve or disapprove the application by ordinance. If an application is disapproved, changes may be suggested. The application can then be revised and resubmitted.
THE FINANCIAL AGREEMENT

- Every approved project must be evidenced by a financial agreement between the municipality and the Urban Renewal Entity. Any amendments or modifications made after that time must be made by mutual consent of both parties, subject to approval by ordinance of the municipal governing body upon the Mayor or Chief Executive Officer’s recommendation prior to taking effect. This financial agreement must be in the form of a

Contract requiring full performance within 30 years from the date of completion of the project, and in accordance with N.J.S.A 40A:20-9, must include the following:

- That the profits of or dividends payable by the Urban Renewal Entity will be limited according to the terms appropriate for the type of entity in conformance with the provisions of this act.
- That all improvements in the proposed project will be exempt from taxation
- That the Urban Renewal Entity will make payments for the municipal services determined by an annual amount equal to a percentage of the annual gross revenue from each unit of the project
THE FINANCIAL AGREEMENT CONT.

- That percentage cannot be less than 10%. Or, if the annual gross rental or gross shelter rent or annual gross revenue cannot reasonably be computed, the governing body will provide that the annual service charge will be a sum equal to a percentage of the total project unit cost calculated from the first day of the month following the substantial completion of any unit thereof. The percentage must be at least 2%. This service charge must be paid in stages, as set forth below pursuant to N.J.S.A 40A:20-12.

- For the first stage of the PILOT, which shall commence upon the date of completion of the unity or of the project, and shall continue for a time of not less than 6 years nor more than 15 years, the URE shall pay an annual service charge in an annual amount as determined by percentage of annual gross revenue or total project costs.

- For the second stage, which shall not be less than 1 year nor more than 6 years, the URE shall pay an annual service charge in an annual gross revenue or total project costs, or 20% of the amount of taxes otherwise due on the value of the land and improvements, whichever shall be greater.
For the third stage, which shall not be less than 1 year nor more than 6 years, the URE shall pay an annual service charge in an annual amount as determined by percentage of annual gross revenue or total project costs, or 40% of the amount of taxes otherwise due on the value of the land and improvements, whichever shall be greater.

For the fourth stage, which shall not be less than 1 year nor more than 6 years, the URE shall pay an annual service charge in an annual amount as determined by percentage of annual gross revenue or total project costs, or 60% of the amount of taxes otherwise due on the value of the land and improvements, whichever shall be greater.

For the final stage, which shall not be less than 1 year and shall be specified in the financial agreement, the URE shall pay an annual service charge in an annual amount as determined by percentage of annual gross revenue or total project costs, or 80% of the amount of taxes otherwise due on the value of the land and improvements, whichever shall be greater.

That the Urban Renewal agency will submit annually, within 90 days after the close of its fiscal year, its auditors reports to the Mayor and governing body of the municipality and to the Director of the Local Government Services in the Department of Community Affairs.
That the Urban Renewal Entity will allow inspection of all facilities of the entity upon request and will also allow examination and audit of all records by authorized representatives of the municipality or the State.

That any disputes will be resolved by arbitration.

That operation under the financial agreement will be terminable by the Urban Renewal Entity in the manner set forth in the statute.

That the Urban Renewal Entity will remain bound by the provisions of the statute at all times prior to expiration or termination of the financial agreement.

The financial agreement must contain detailed representations and covenants by the Urban Renewal Entity as to how it proposes to use, manage, or operate the project, and must also set forth the methods for computing gross revenue of units for the Urban Renewal Entity, which allows the use of the “prevailing lawful interest rate for mortgage financing of comparable properties within the municipality.” It must also set forth the method of determining insurance, operating and maintenance expenses paid by a tenant which are ordinarily paid by a landlord, the plans for financing the project, which includes the estimated total project cost, the amortization rate on the total project cost, the source of funds, the interest rates to be paid on the construction financing, the source and amount of paid-in-capital, the terms of mortgage amortization or payment of principle on any mortgage.
A good faith projection of initial sales prices of condominium units and expenses to be incurred in promotion and consummating such sales, and the rental schedules and lease terms to be used in the project. The financial agreement can also provide that the municipality will consent to a sale of the project or any portion thereof has been devoted to condominium ownership, and to their successors, assigns, all owning no other condominium unit of a project at the time of the transfer, and that, upon assumption by the condominium unit purchaser of the transferor’s obligations under the financial agreement, the tax exemption of the improvement shall continue and inure to the unit purchaser, his respective successors or assigns. See N.J.S.A 40A:20-10
Determining the Annual Service Charge or PILOT

- Pursuant to N.J.S.A 40A:20-12, the LTTE provides two alternative methods by which to calculate the amount of the annual PILOT. One method is predicated on an annual PILOT equal to a percentage of total project cost and the other method bases the annual PILOT on a percentage of annual gross revenue. As indicated at N.J.S.A. 40A:20-12(b), the percentage of annual gross revenue method for calculating the PILOT is the default manner of calculating the PILOT. However, the LTTE provides the municipality with the ability to employ the alternate method of basing the PILOT on a percentage of total project cost, stating that:

- At the option of the municipality, or where because of the nature of the development, ownership, use or occupancy of the project or any unit thereof, if the project is to be undertaken in units, the total annual gross rental or gross shelter rent or annual gross revenue cannot be reasonably ascertained (N.J.S.A. 40A:20-12(b)(2))
CALCULATION OF PILOT BASED ON ANNUAL GROSS REVENUE

The LTTE states at N.J.S.A. 40A:20-12(b)(2) that the annual PILOT may be based on at least 10% of the annual gross revenue for the project. The LTTE defines annual gross revenue as follows:

- “Gross Revenue” means annual gross revenue or gross shelter rent or annual gross rents, as appropriate, and other income, for each Urban Renewal Entity designated pursuant to P.L. 1991, c. 431 (C.40A:20-1 et seq). 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 the gross revenue; provided, however that any federal funds received, whether directly or in the form of rental subsidies paid to tenants, by a nonprofit corporation that is the sponsor of a qualified subsidized housing project, shall not be included in the gross revenue of the project for purposes of computing the annual services charge for municipal services supplied to the project; and provided further that any gain realized by the Urban Renewal Entity on the sale of any unit in fee simple, whether or not taxable under Federal or State Law, shall not be included in computing gross revenue {N.J.S.A. 40A:20-3a}

As is apparent from the above, “gross revenue” is a fairly expansive definition and essentially includes the annual gross rentals received by the Urban Renewal Entity (“URE”)
Under N.J.S.A. 40a:20-12(b)(1), the annual PILOT must be at least 2% of total project cost. The LTTE requires that the Financial Agreement between the municipality and the URE explicitly define total project cost for the PILOT. N.J.S.A 40A:20-12 and N.J.S.A. 40A:20-11. In defining total project cost, however, the LTTE mandates that the Financial Agreement incorporate the definition of total project cost contained in N.J.S.A. 40A:20-3h, which provides, in relevant part, that:

“Total project unit cost” or “total project cost” means the aggregate of the following items as related to a unit of a project, if the project is undertaken in units, or to the total project,

- Cost of the land and improvements to the entity, whether acquired from a private or a public owner, with cost in the case of leasehold interests to be computed by capitalizing the aggregate rental at a rate provided in the Financial Agreement,
- Architect, engineer and attorney fees, paid or payable by the entity in connection with the planning, construction and financing of the project,
- Surveying and testing charges in connection therewith.

If the project is not undertaken in units, all of which as limited by, and approved as part of the financial agreement:

1. Cost of the land and improvements to the entity, whether acquired from a private or a public owner, with cost in the case of leasehold interests to be computed by capitalizing the aggregate rental at a rate provided in the Financial Agreement.
2. Architect, engineer and attorney fees, paid or payable by the entity in connection with the planning, construction and financing of the project.
3. Surveying and testing charges in connection therewith.
CALCULATION OF A PILOT BASED ON 2% OF TOTAL PROJECT COST

4. Actual construction costs which the entity shall cause to be certified and verified to the municipality and the municipal governing body by an independent and qualified architect, including the cost of any preparation of the site undertaken at the entity’s expense.

5. Insurance, interest and finance costs during construction.

6. Costs of obtaining initial permanent financing.

7. Commissions and other expenses paid or payable in connection with initial leasing.

8. Real estate taxes and assessments during the construction period.

9. A developer’s overhead based on a percentage of actual construction costs, to be computed at not more than the following schedule:
CALCULATION OF A PILOT BASED ON 2% OF TOTAL PROJECT COST

- $500,000 or less - 10%
- $500,00 through $1,000,000
- $50,000 plus 8% on excess above $500,000
- $1,000,000 through $2,000,000
- $90,000 plus 7% on excess above $1,000,000
- $2,000,00 through $3,500,000
- $160,000 plus 5.6667% on excess above $2,000,000
- $3,500,00 through $5,500,000
- $245,000 plus 4.25% on excess above $3,500,000
- $5,500,00 through $10,000,000
- $330,000 plus 3.7778% on excess above $5,500,000 over $10,000,000 - 5%