

New Jersey Law Journal

VOL. CLXXVI – NO. 12 – INDEX 1172

JUNE 21, 2004

ESTABLISHED 1878

Real Estate
Title Insurance

Clearing the Way for Smart Growth

The Long Term Tax Exemption Law enables municipalities to level the playing field for redevelopment areas

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Tax incentives under The Long Term Tax Exemption Law (LTTE) are one of the few remaining ways municipalities can provide substantial financial assistance to offset the costs often associated with areas in need of redevelopment. N.J.S.A. 40A:20-1 et seq., as amended by P.L. 2003, c. 125 (LTTE Amendments). The costs, which are not usually encountered in “corn field” development, include lengthy and expensive multiple property acquisitions, relocation costs, and environmental remediation. Moreover, redevelopment often takes place in municipalities where taxes are relatively high.

Without financial incentives, these costs and high taxes would tend to discourage private investment in most redevelopment areas. The dependence of redevelopment on financial incentives was recognized by Justice Francis in *Levin v. Bridgewater*, 57 N.J. 506, 512 (1971). Unlike the days when substantial financial incentives were available from programs like the Federal Urban Development Action Grants pro-

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gram, there are few public sources of funding available today.

The potential occupants of a redevelopment project must consider whether they can afford to pay these costs of redevelopment through higher purchase prices or rents and the higher taxes often prevailing in such areas. The LTTE anticipates that municipalities will find that the tax incentives it authorizes will be important in “obtaining the development of the project and in influencing the locational decisions of probable occupants of the project or units of the project.” N.J.S.A. 40A:20-11.

Tax exemption pursuant to the LTTE is a means of accomplishing the redevelopment and rehabilitation purposes of the state's Local Redevelopment and Housing Law, N.J.S.A. 40A:12A-1 et seq., through the use of private entities. N.J.S.A. 40A:20-2. The LTTE enables municipalities to clear the way for smart growth by leveling the playing field for redevelopment areas.

Smart Growth

“Smart growth” refers to growth in locations that the Department of Community Affairs has identified that will provide for much of the state's future development and redevelopment, promoting growth in compact forms and protecting the character of existing

stable communities. DCA defines the smart growth areas as “[State Plan] Planning Area 1, Planning Area 2 (sewered), Designated Centers, Proposed Centers (sewered) and Identified Centers (sewered).” N.J.A.C. 5:80-33.2. The State Planning Act (State Plan) seeks to encourage revitalization of such areas, including the state's urban centers, while promoting beneficial economic growth, development and renewal. N.J.S.A. 52:18A-196.

When municipalities employ the LTTE to induce smart growth, they do not absolve the occupants of redevelopment projects of the responsibility to pay for municipal services. During the limited period of an exemption (generally no more than 30 years from completion of the exempt improvement), exempt projects pay for the cost of municipal services in the form of payments in lieu of taxes (PILOTs), also referred to in the statute as “annual service charges.” At the end of the exemption, they pay through traditional real estate taxes. N.J.S.A. 40A:20-12.

Because improvements that are tax-exempt are not included in county equalization tables, almost all of the revenue received by a municipality in the form of PILOT payments is retained to defray municipal service costs (LTTE Amendments require that 5 percent of the PILOT be remitted to the county). Municipal discretion to set PILOTs to cover the cost of municipal service, but not county costs, has been upheld by the courts:

The exclusion of revenue received by municipalities by way of service charges under N.J.S.A. 55:14K-37(b) from

county and state equalization tables applies equally to all municipalities. True, the amount actually excluded from the tables may vary by municipality. The Legislature, however, has wide discretion in allocating the burdens of government. It has plainly and unmistakably here exercised that discretion. Absent a constitutional or legal error, it is not the judicial function to review the societal merit of a legislative program which may sacrifice some tax revenue for another perceived public objective. *Township of North Bergen v. Jersey City*, 232 N.J. Super. 219, 231-32 (App. Div. 1989). See also, *Secaucus v. Hudson County Board of Taxation*, 17 N.J. Tax 215, 224 (Tax Court, 1998).

Thus, a municipality's discretion to exclude redevelopment projects from the sharing of the county tax burden is well supported. Deciding to what extent the municipality will use PILOT payments for school funding is also a municipal decision. If the project does not add school children to the municipality, the decision to employ the PILOT solely for municipal services certainly would appear to be a reasonable one.

Eligibility for LTTE

An exemption under the LTTE can only be approved for "[t]he rehabilitation or improvements made in the development or redevelopment of a redevelopment area or area appurtenant thereto or for a redevelopment relocation housing project." N.J.S.A. 40A:20-12. A "redevelopment area" is defined in N.J.S.A. 40A:12A-5 as an area wherein there exists any one of eight factors described in the statute.

Eligibility factors include conditions such as: dilapidated dwellings; abandoned manufacturing buildings; vacant land which is not likely to be developed through the instrumentality of private capital; underutilized areas potentially useful and valuable for contributing to and serving the public

health, safety and welfare; buildings that have been destroyed by certain natural disasters; and, for certain purposes, property in an urban enterprise zone. The LTTE Amendments also added to the list of factors "[t]he designation of the delineated area is consistent with smart growth planning principles adopted pursuant to law or regulation."

PILOT Calculation

The minimum annual service charge is the amount of the total taxes levied against all real property in the area covered by the project in the last full tax year in which the area was subject to taxation. N.J.S.A. 40A:20-12. In other words, if the land and improvements on the property for which the exemption is being made generated \$200,000 in taxes before redevelopment, the minimum PILOT would be \$200,000.

Generally, the annual service charge is calculated by setting a percentage that will be applied to the Annual Gross Revenue (AGR) or Total Project Costs (TPC). In the case of AGR, the percentage must be 1) not more than 15 percent of AGR in the case of low and moderate income housing; 2) not less than 10 percent of AGR in the case of office projects; and 3) not less than 10 percent of AGR in the case of all other projects. Where the municipality opts to use TPC as the basis for the PILOT, the percentage applied to TPC must be: not more than 2 percent of TPC in the case of low and moderate income housing; and not less than 2 percent of TPC in the case of all other projects.

However, the payment must also increase over five stages of the term of the financial agreement. The lengths of the stages, and the term of the financial agreement, are to be agreed upon by the recipient of the tax exemption (an "urban renewal entity") and the municipality, within the limits set forth in the LTTE. During the initial stage, which can be anywhere from six to 15 years. During the initial stage, the PILOT is calculated based on the formula in the preceding paragraph. For the remainder of the period of the exemption, if any, the annual service charge will be deter-

mined by: the greater of either (1) the formula described above, or (2) in Stage 2 (minimum one year, maximum six years), 20 percent of normal taxes; Stage 3 (minimum one year, maximum six years), 40 percent of normal taxes; Stage 4 (minimum one year, maximum six years), 60 percent of normal taxes; and Stage 5 (minimum one year), 80 percent of normal taxes. N.J.S.A. 40A:20-12(2)(a).

Restrictions on Recipient of Exemption

Any duly formed corporation, partnership, limited partnership, limited partnership association, or other unincorporated entity may qualify as an urban renewal entity, provided that it: (a) agrees to limit its profits; (b) includes the required provisions in its certificate of incorporation or other similar certificate or statement, and that the document has been reviewed and approved by the Commissioner of the Department of Community Affairs; (c) enters into a financial agreement with the municipality containing certain required provisions (N.J.S.A. 40A:20-4, 8-11.); (d) agrees to limitations on its ability to transfer ownership of the entity; and (e) includes the words "Urban Renewal" in the name of the entity.

The provisions that limit profits of the entity were modified in the LTTE Amendments. "Allowable net profits of the entity shall be determined by applying the allowable profit rate to ... the total project cost ... , and all capital costs, determined in accordance with generally accepted accounting principles, of any other entity whose revenue is included in the computation of excess profits." N.J.S.A. 40A:20-3. "Allowable profit rate" means "the greater of 12% or the percentage per annum arrived at by adding 1-1/4% to the annual interest percentage rate payable on the entity's initial permanent mortgage financing." *Id.* "Net profit" means "the gross revenues of the urban renewal entity less all operating and non-operating expenses of the entity, all determined in accordance with generally accepted accounting principles." *Id.*

Gross revenues include "annual gross revenue or gross shelter rent or annual gross rents, as appropriate, and

other income, for each urban renewal entity ... [and] insurance, operating and maintenance expenses paid by a tenant which are ordinarily paid by a landlord." *Id.* Certain expenses are specifically allowed, such as debt service, and other enumerated expenses are disallowed, such as depreciation or obsoles-

cence, interest on debt (except interest which is part of debt service), income taxes, and salaries, bonuses or other compensation paid, directly or indirectly, to directors and officers. *Id.* The calculation of net profit is cumulative, commencing on the date the construction of the first unit of the project is

completed, and terminating at the end of the last full fiscal year. N.J.S.A. 40A:20-15.

The tax incentives made available under the LTTE, including the LTTE Amendments, remain a vital part of the tools for encouraging redevelopment that is consistent with the State Plan. ■