

Overview of Annual Service Charges (or PILOTs) In New Jersey



June 18, 2025

What are Annual Service Charges/ PILOTs?

- An Annual Service Charge (ASC) is the statutory term for a Payment-in-Lieu-of-Tax, or “PILOT”.
- An Annual Service Charge replaces the conventional tax on improvements, and in the case of residential projects, may replace the conventional tax on land.
- Annual Service Charges are a critical tool in the municipal toolkit to effectuate redevelopment of underutilized and unproductive properties.

What are Annual Service Charges/ PILOTs? (continued)

- “But For” the Annual Service Charge, the redevelopment project would not be built as designed by the developer and approved by the municipality.
- Annual Service Charges are permitted pursuant to the Long Term Tax Exemption Law.
- Available since 1992, Annual Service Charges are used State-wide to effectuate billions of dollars worth of redevelopment projects.

Where is Long Term Tax Exemption Available?

- Area in need of redevelopment, *N.J.S.A. 40A:12A-6*
- Urban enterprise zone, *N.J.S.A. 40A:12A-5(g)*
- Affordable housing project, *N.J.S.A. 40A:20-4*
- Relocation housing project, *N.J.S.A. 40A:20-4*

Area in Need of Redevelopment Designation – *N.J.S.A. 40A:12A-6*

- Municipality identifies area for investigation (the “Study Area”) and directs Planning Board to investigate it for compliance with the statutory criteria at *N.J.S.A. 40A:12A-5*
 - Condemnation v. Non-Condemnation
- Planning Board holds public hearing, and makes recommendations to municipality
- Municipality designates area in need of redevelopment by resolution
- Public notice of designation
- Copy of designation resolution provided to the Commissioner of the Department of Community Affairs

Annual Service Charge Amount

- The ASC amount to be paid is determined as follows:
 - At least 10% of annual gross revenue or 2% of total project costs.
 - Increases in stages as a percentage of otherwise applicable taxes of the term of the Financial Agreement.
- 95% of the ASC goes to the municipality and 5% to the County.
- Maximum term of 30 years from completion or 35 years from execution of Financial Agreement, or 50 years if 2 or more sequential projects being undertaken.

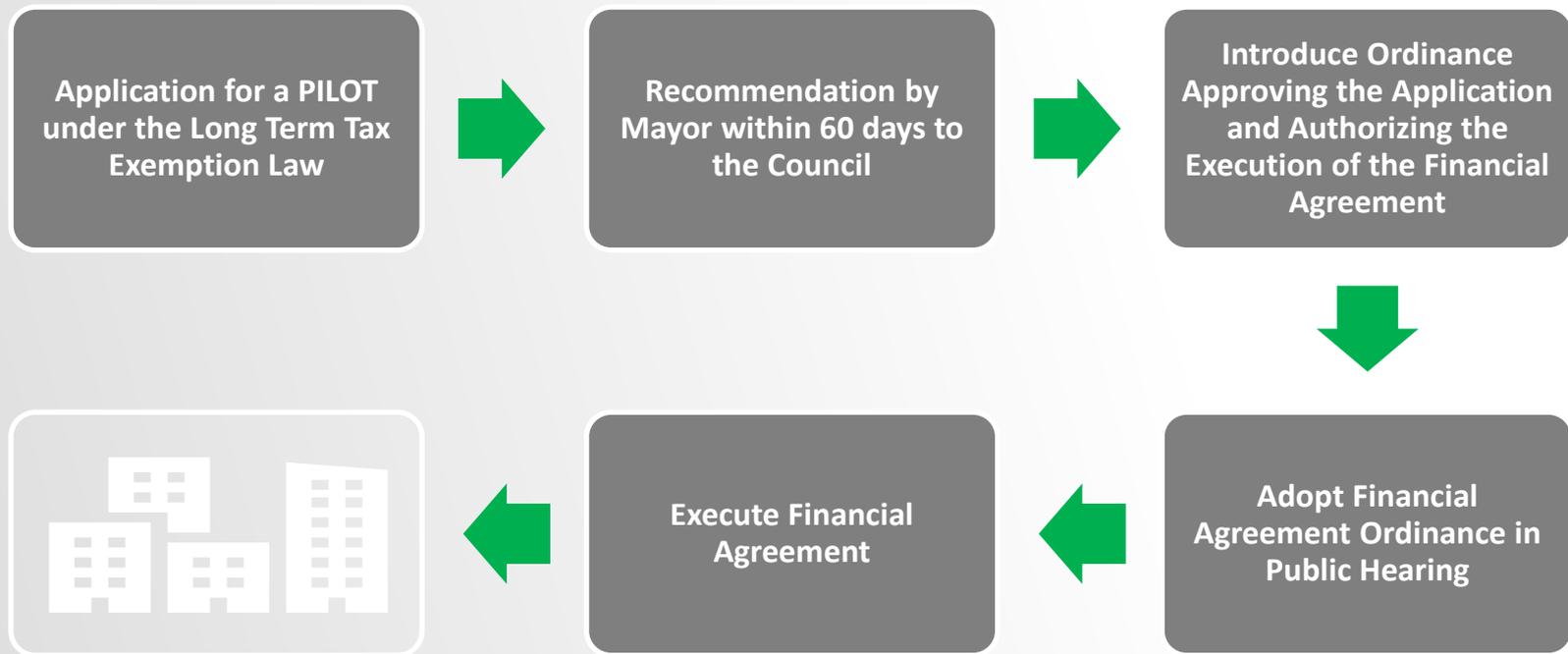
Who Can Pay an Annual Service Charge?

- An “Urban Renewal Entity” or, if the project includes “for sale” residential units, the condo owners of those units, may pay an Annual Service Charge.
- An Urban Renewal Entity, or URE, is a limited dividend entity that has been designated by the municipality to build a redevelopment project.

Who Can Pay an Annual Service Charge? (continued)

- The amount of profit a URE can make on a redevelopment project is restricted by law.
- Any “excess profits” are paid to the municipality.
- URE cannot file tax appeal on project while paying Annual Service Charge.
- URE can opt out of the Annual Service Charge after one year, in certain circumstances.

PILOT Process Under LTTE Law



Application for an ASC

- The URE submits a written application to the municipality for approval of the project.
- The Application contains:
 - Description of the proposed project;
 - Architectural / site plans;
 - Architect / engineer certification as to project cost;
 - Amount and source of funds to complete project;
 - Fiscal plan for the project; and
 - Form of Financial Agreement.

Application for an ASC (continued)

- Mayor reviews Application and makes recommendations to municipal governing body.
- Governing body by resolution (or ordinance) approves or disapproves the Application.

Financial Agreement

- A Financial Agreement is an agreement between the municipality and URE that memorializes the terms of an ASC granted to a URE's approved project.
- A Financial Agreement includes the following:
 - The amount of ASC to be paid annually;
 - Limitation on profits of the URE;
 - Exemption of improvements and, in residential projects, land from traditional taxation;
 - Requirement that URE submits annual audit to municipality;
 - Municipal charge of annual Administrative Fee.

Long Term Tax Exemption - Terms

- The land may be conventionally taxed. The developer may receive a credit against the PILOT payment for the prior year's land taxes
- PILOT payments are collected on the same dates and enforced in the same way as conventional taxes
- Must provide annual audits to municipality and pay over excess profits to municipality
- Agreement may restrict transfer of the project
- Municipality may require affordable housing or payment to affordable housing trust fund as condition of approval
- Agreement may limit continuation of exemption for individual condominium unit purchasers to owner-occupied units
- Ability to appeal real estate taxes is limited

PILOT Benefits

- Allow for projects not otherwise financially feasible
- Promotes redevelopment of areas which need it.
- Can provide greater revenues to the municipality than conventional taxes
- Potential to negotiate better public improvements
- Can be less than conventional taxes.
- More stability and certainty than conventional taxes
- Market based taxation: If the market is stronger than expected, municipality shares in the market upside because PILOTs are collected based on annual gross revenue. If ownership is unable to fully lease up, or market rents decrease, they are not burdened with a fixed tax obligation
- Percentage of annual gross revenue grows over time – lower during stabilization, supporting project feasibility.
- Ongoing transparency – audited financial statements.

Common Misconceptions

- Misconception: PILOT = No Taxes
- Misconception: Municipality receives less money than it would under conventional taxes
- Misconception: The cost of additional services exceed PILOT revenue
- Misconception: PILOTs cause an increase in property taxes for existing residents
- Misconception: The schools won't receive their full budget

ASC - 180 Unit Residential Project

- Following a review of the proposed Redevelopment Project's construction, revenue and expense financials, the municipality's professionals have concluded that, "but for" an ASC, the proposed Redevelopment Project would not be economically feasible.

| <u>Market Value Calculation</u> | |
|------------------------------------|--------------------|
| Projected Collected Rent | \$4,276,300 |
| Operating Expenses Before RE Taxes | 724,800 |
| Net Income | <u>\$3,551,500</u> |
| <u>Return Requirements</u> | |
| Owner/Investor | 5.70% |
| Effective Tax Rate | 2.15% |
| Total Rate of Return (Cap Rate) | <u>7.85%</u> |
| Projected Market Value (No PILOT) | \$45,231,000 |

| <u>Development Cost</u> | |
|---------------------------------|---------------------|
| Land Costs | \$10,200,000 |
| Soft Cost/Development | 4,608,000 |
| Construction Budget (Hollister) | 39,503,645 |
| Finance Costs | 1,396,000 |
| Leasing Cost | 805,000 |
| Total Development Cost | <u>\$56,512,645</u> |
| Market Value Upon Completion | <u>45,231,000</u> |
| Gap (Loss) | 11,281,645 |

ASC - 180 Unit Residential Project

(continued)

- Development costs exceed market value by over \$11 million.
- Under conventional taxation, the Redevelopment Project is not economically feasible.
- No developer would build a project with these economics, absent an Annual Service Charge.

ASC - 180 Unit Residential Project

(continued)

- Based on the projected rents and expenses, the completed Redevelopment Project will generate \$3,551,500 in net income before real estate taxes.
- The URE needs \$3,221,221 to meet market return requirements (5.70%), leaving \$330,279 available for annual real estate tax payments.
- The tax payment translates to 7.72% of collected rent, below the statutory minimum ASC of 10% of Annual Gross Revenue (AGR).
- The URE has agreed to a 10% ASC, thus reducing their return on equity to \$3,123,870 or 5.53%.

| <u>RE Taxes to Meet Construction Cost</u> | |
|-------------------------------------------|------------------|
| Construction Cost | 56,512,645 |
| Net Income | 3,551,500 |
| Market Rate of Return | x 5.70% |
| Return to URE | <u>3,221,221</u> |
| Dollars Available for RE Taxes | 330,279 |
| as a % of AGR | 7.72% |
| <u>PILOT Calculation</u> | |
| Construction Cost | 56,512,645 |
| Net Income | 3,551,500 |
| Payment at 10% of AGR | <u>-427,630</u> |
| Return to URE | 3,123,870 |
| URE Return on Equity | 5.53% |

Municipal Revenue Analysis

| PILOT Comparison | Payment | Municipal Share | Municipal Revenue |
|-------------------------|-------------------|------------------------|--------------------------|
| Conventional Taxes | \$973,167 | 17.61% | \$171,375 |
| PILOT @ 10.0% AGR | \$427,630 | 95.00% | \$406,249 |
| Difference | -\$545,537 | | \$234,874 |

- If conventionally taxed, the Redevelopment Project would not be built.
- By granting a tax exemption and ASC:
 - The tax bill is lowered to an amount the URE can afford to pay and the Project gets completed, without increasing density or decreasing design amenities; and
 - Annual tax revenue to the Municipality increases by 137%.

Why an ASC for this Property?

- Produces a financially feasible project that meets the Municipality's design standards.
- Generates more tax revenue to the Municipality than the current assessment (\$406,249 v. \$51,721).
- Does not preclude allocation of a portion of ASC to School District to cover increased costs (if any) attributable to the Redevelopment Project.
- Allows the Municipality to dictate the project's size, height, architectural elements and number of units.
- ASC payments increase as rents increase.
- Helps the Municipality meet its affordable housing requirements.

General Obligation Bonds

- Municipality may issue bonds to aid a redevelopment entity (including the municipality itself) in implementing a redevelopment plan
- Generally subject to customary Local Bond Law procedures, however, down payment is not required, and the useful life/maturity are not governed by the Local Bond Law
- Authorized by bond ordinance
- Secured by general obligation pledge of the municipality

Revenue Backed Bonds

- May be issued by municipality acting as redevelopment entity
- Authorized by resolution rather than ordinance
- Secured by revenues of the project, e.g., loan repayments
- Only secured by the municipality's credit if the municipality decides to do so
- If not, the debt does not become part of the municipality's debt statement or apply against its debt limit
- Local Finance Board approval needed to sell at private sale or for less than face value

Redevelopment Area Bonds

- Allows for the pledge of PILOTs or special assessments to bondholders
- If pledged, the PILOT agreement or special assessment agreement is recorded against the project, and establishes a municipal lien on the property
- This pledge may be in lieu of or in addition to municipal security
- Local Finance Board approval is needed to pledge PILOTs or special assessments

MS&B

McMANIMON • SCOTLAND • BAUMANN

Jennifer L. Credidio, Esq.

Matthew D. Jessup, Esq.

McManimon, Scotland & Baumann, LLC

75 Livingston Avenue, Roseland, NJ 07068

(973) 622-1800

www.msbnj.com