TAX ABATEMENTS

A Necessary Tool for the Revitalization of Hackensack's Rehabilitation and Redevelopment Areas

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Legal Basis for Tax Abatements

- New Jersey's 1947 Constitution provides authority for the granting of tax abatements to encourage redevelopment of blighted areas in which properties **"may be exempted from taxation, in whole or in part, for a limited period of time during which the profits and dividends payable by any private corporation enjoying such tax exemption shall be limited by law."**

- In 1961, the Urban Renewal Corporation & Association law (also known as the Fox-Lance Act) authorized the first formal abatement program, allowing blighted municipalities to grant tax abatements for up to 15 years at either 15% of the project's annual gross income, or 2% of the project cost.

- As a result of the success of early tax abatements in Jersey City, in 1991, the current abatement law was enacted, allowing for long term abatements of up to 30 years on larger projects, or short term abatements of 5 years generally used for residents making improvements to their homes or small businesses.

Hackensack’s Abatement Ordinance

Earlier this year the City adopted a short term (5 year) tax abatement ordinance that:

1. Applies to the downtown rehabilitation area or any areas having been declared “an area in need of redevelopment.”
2. Applies to commercial, industrial or residential properties.
3. May be applied for through the tax assessor’s office, subject to approval of the governing body.
4. Does not require formation of non-profit or special limited profit urban renewal entity.
5. Program sunsets after 10 years unless reauthorized.

Adoption of Long Term Tax Abatements

- Can only be utilized in areas having already been determined to be "an area in need of redevelopment." Does not apply to rehabilitation areas unless a portion thereof is also designated as "an area in need of redevelopment."

- All long term tax abatement agreements, known as Payment In Lieu of Tax Agreements ("PILOTs") must be individually negotiated between the municipality and the designated redeveloper.

- Long term tax abatements can only be adopted by an ordinance of the governing body after appropriate public notice and a public hearing is held.

- Any PILOT Agreement entered with a redeveloper must be maintained and monitored by the city's tax assessor who receives annual financial statements from the redeveloper to determine whether appropriate sums are annually being paid.

Terms of Long Term Tax Abatements

- May be up to 30 years in duration, but not effective more than 35 years from the date of the execution of the agreement.

- The abatement may only apply to the value of new improvements on the property, not the value of the land.

- A municipality may charge up to 2% of the total project cost, or a percentage (usually no more than 15%) of the project's annual gross revenue (limitations for affordable housing and office projects).

- Over the term of the agreement, the project must be phased into full taxation, which occurs in 20% increments.

Distribution of PILOT Payments

- Determined by law, not by the PILOT Agreement.
- 5% must be paid to the county government.
- The remaining 95% is paid to the municipal government and can be distributed to the schools at its discretion if costs are realized.
- Municipalities almost always realize significantly more revenue than they would under conventional taxation.

The Challenge Presented – Part 1

- Many older urban centers that have not witnessed significant development in recent years experience higher property taxes than surrounding suburban communities where most investment has taken place in recent decades.

- This causes tax rates to continue to increase as the City’s ratable base deteriorates while expenses to maintain aging infrastructure and demand for public services increase.

- Once this cycle begins, it is not easy to stop, as organic market-based incentives for new development and investment are greatly diminished and blight sets in.

- Generally only non-taxable government or other non-profit institutions develop in such marketplaces, further reducing the City’s taxable land area and eroding the ratable base.

The Challenge Presented – Part 2

- New Jersey has a very weak market for office, commercial, retail and industrial properties, which make up the majority of the city's downtown and riverfront corridor.
- Generally, the only significantly marketable use for underutilized properties in the City is residential development, and principally rentals due to tightened mortgage lending standards.
- It has been decades since any significant residential project has been developed in the City's downtown and riverfront corridor.
- This means that as far as banks that finance such projects are concerned, there is no comparable market for residential development in these areas.

Policy Reasons for Abatements

- Promote economic development and job creation.
- Revitalize diminishing tax base to support city services.
- Catalyst for investment in surrounding properties.
- Return residents and customers to the city’s downtown.
- Keeping the full market value of new projects “off the books” so as not to affect the city’s (and schools) ability to secure state aid.

Why Are Abatements Necessary?

- Abatements create certainty as to the tax costs over the term of financing for the project. (It is not a coincidence that the maximum term of long term PILOTs coincides with the most commonly used financing term—30 years).

- The City does not have a track record of successful significant residential developments in the downtown or riverfront corridor.

- The current lending environment is very difficult, and absent actual comparable projects brought to completion that are fully occupied with established base rents, banks will not lend.

False Assumptions

- By law, tax abatements may not be used to reduce taxes on a property. In no circumstance can PILOT payments be less than the last full year of conventional taxation.

- Comparing PILOT payments to theoretical conventional tax payments upon full build out is a fruitless exercise as you cannot count money that you do not have in relation to a project that is unlikely to be built in the absence of an abatement.

- Schools do not necessarily lose out when abatements are utilized because revenues received by abatement are not counted when calculating state aid. If the full value of a new development, however, were added to the city's ratable base, there could potentially be a proportionate reduction in state aid.

Case Study: Jersey City

- Despite criticism, Jersey City has been aggressively using long term tax abatements to promote redevelopment for 30 years while others have hesitated.

- Even though real estate values fell in many regions of the state over the last decade resulting in devastating tax appeal judgments, real estate values in Jersey City have increased nearly 300%.

- Jersey City's population, which shrank by 25% between 1950 and 1980, has returned to levels not seen since 1950, which will likely result in Jersey City becoming the state's largest city in the next 5 years.

- Jersey City currently has 5,609 residential units under construction with 17,089 units approved, employing thousands of individuals while adding $118 million to Jersey City's ratable base last year alone.

- Nearly all of these project received long term tax abatements, which Jersey City continues to grant in areas still in need of redevelopment.

A View of Hackensack

Despite being only a short distance from New York City and having significant access to public transportation, Hackensack's story is very different:

- The City has granted only one tax abatement on the only significant private project under construction in downtown in decades.
- The City's ratable base has been dropping by more than 6% a year, one of the highest drops in Bergen County with little end in sight.
- $10 million in tax appeal refunds that have to be financed, which are devastating because the city must bear the burden of not only its portion of the tax bill, but also the schools portion for which no reimbursement is received.
- Hackensack, however, currently has an opportunity to encourage significant redevelopment that cannot be missed.

Checks & Balances

- In order to secure a long term tax abatement, the developer must form what is known as an Urban Renewal Entity approved by the DCA, which by law, limits the dividends or profits of the development corporation. Financial statements must annually be provided and excess profit can be recaptured.

- PILOT agreements on rental developments are usually based on a percentage of a project's annual gross revenue. If rents increase, so do the PILOT payments, accordingly the City's taxpayers share in the success of the project.

- Jersey City, for example, recouped $18 million (and counting) last year reconciling older PILOT Agreements where excess profits were achieved due to the success of redevelopment efforts, increasing property values and rents.

Responsible Use of Abatements

A City's decision to use tax abatements must be based on a case by case analysis of the benefits of the proposed project and the need for the abatement to attract the development in consultation with the City's tax assessor, CFO and other professionals. Factors considered should include, but not necessarily be limited to:

1. The type and magnitude of the development.
2. Impact of local tax rate on the profitability of the project.
3. The ability of the developer to secure financing.
4. The fiscal impact on, or costs added to the community.