Proposed Legislative Changes to PILOT Programs May Negatively Impact Redevelopment in 2018

Attorneys
Robert S. Goldsmith
Steven G. Mlenak

Robert S. Goldsmith and Steven G. Mlenak

Greenbaum, Rowe, Smith & Davis LLP Client Alert
February 2018

For decades, New Jersey has experienced notable success with redeveloping many of its distressed areas by affording municipalities the ability to provide tax incentives to redevelopers (e.g., PILOTs). These incentives encourage redevelopers to accept the substantial risks and additional costs that come with most redevelopment projects – for example, the risk factor for unknown markets and the often-required construction of structured parking (at a cost of roughly $25,000 per space vs. $3,000 per space in a surface lot). Without such incentives, many of the highly touted redevelopment projects that have revitalized many of the state's distressed areas would have been economically infeasible. Despite this proven track record of success, there are two bills pending before the New Jersey Legislature which could inhibit many redevelopment projects:

S867, entitled *"Imposes prevailing wage for public work on properties receiving tax abatements or exemptions,"* would require that redevelopers pay prevailing wage for the construction of projects approved for a tax abatement or tax exemption, unless the property or premises is already exempt from taxation.

The general purpose of tax abatements and tax incentives is to provide an opportunity for redevelopers to overcome the gap between what a project will cost and its projected income. Even with such incentives, many successful redevelopment projects in New Jersey have operated with razor-thin margins. By agreeing to a PILOT, redevelopers are also agreeing to cap their profits (a sacrifice they are willing to make because the expected revenue is often well below the statutory limits). Imposing prevailing wage upon such projects could serve to neutralize the benefit of the abatement/exemption by imposing what some believe to be additional costs in the range of 20-30% for prevailing wage. These

additional costs would likely eat up the savings obtained by the abatement, therefore rendering many redevelopment projects economically infeasible.

S59, entitled *"Requires municipalities to share certain payments received in lieu of property taxes with school districts; informs counties and school districts of application for property tax exemptions,"* would require that municipalities receiving payments in lieu of taxes (PILOT) remit a portion of such payments to its school district(s), including regional school districts, in an amount calculated by multiplying the number of school-age children attending public school that reside in an approved project by the district's budgetary cost per pupil. The redeveloper responsible for making the PILOT payments would be required to certify in their annual audit the number of school-age children residing within the approved project who attend public school.

S59 would essentially remove the financial incentive that municipalities would have to enter into PILOT arrangements for residential projects, although the bill would likely have a minimal impact on industrial or commercial projects. In addition to greatly reducing a municipality's take-home revenue from the PILOT, municipalities would be forced to undertake significant risk when granting tax abatements for residential projects. Conceivably, as there are no caps or restrictions on the amount of the proceeds to be sent to the school district, a residential project with a high percentage of school-age children could result in the municipality having to remit its entire revenue to the school district(s), thus resulting in less revenue than had the municipality denied the application. It is likely that this bill will see some municipalities attempting to shift that risk to the redeveloper to cover some or all of this payment to the school district(s), thus increasing the redeveloper's risk. With the passage of the recent federal tax reforms affecting the housing industry, the uncertainty to developers is even greater. Further, the bill offers no distinction between rental housing and for-sale condominium housing. Would the owners of each individual unit be subjected to having to pay the per-pupil cost for any children they have if the municipality shifted the burden of such expenses to the redeveloper?

Should S59 be adopted, redevelopers should also be cautious of housing discrimination issues, as a redeveloper, knowing that they will be responsible for tens of thousands of dollars per child, could inadvertently violate anti-discrimination laws by marketing their dwellings to encourage non-families.

Yet another issue to consider is that S59 does not address the actual costs of schoolchildren, but instead generalizes those costs to the average cost per pupil in that district. If a school district has a budget of $1 million with 100 students, its average cost per pupil is $10,000. If a new student enrolls in the district, the cost of running the district does not increase to $1,010,000. Rather, in all likelihood, the average cost per pupil would be reduced to around $9,900. No new teachers or staff would be hired, and no buildings would need to be constructed. There would be no incurred capital costs. It is likely a matter of some additional supplies. Even if a redevelopment project added ten or twenty schoolchildren, they would likely be of varying ages and spread out at various grade levels. Further, research has revealed that affordable housing projects typically yield a higher number of schoolchildren than market-rate units. This bill, therefore, could have the unintended consequence of discouraging affordable housing.

We will be tracking the status of this legislation closely and will keep our clients advised regarding any developments, as it is important that property owners and land developers stay cognizant of the proposed legislative changes to programs such as PILOT.