

Overview of Annual Service Charges (or PILOTs) for the Kings Redevelopment Project



July 18, 2017

What are Annual Service Charges/ PILOTs?

- An Annual Service Charge 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 permitted pursuant to the Long Term Tax Exemption Law.

What are Annual Service Charges/ PILOTs? (continued)

- Annual Service Charges are a critical tool in the municipal toolkit to effectuate redevelopment of underutilized and unproductive properties.
- But for the Annual Service Charge, the redevelopment project would not be built.

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.

Application for an ASC

- The URE submits a written application to the municipality for approval of the project.
- 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.

What is a 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.

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.

ASC for the Former Kings Site

- “But For” an ASC, the project would not be economically feasible.

<u>Market Value Calculation</u>		<u>Development Cost</u>	
Projected Collected Rent	\$4,276,300	Land Costs	\$10,200,000
Operating Expenses Before RE Taxes	724,800	Soft Cost/Development	4,608,000
Net Income	\$3,551,500	Construction Budget (Hollister)	39,503,645
<u>Return Requirements</u>		Finance Costs	1,396,000
Owner/Investor	5.70%	Leasing Cost	805,000
Effective Tax Rate	2.15%	Total Development Cost	\$56,512,645
Total Rate of Return (Cap Rate)	7.85%	Market Value Upon Completion	45,231,000
Projected Market Value (No PILOT)	\$45,231,000	Gap (Loss)	11,281,645

- Under conventional taxation, the project is not economically feasible.
- Development costs exceed market value by over \$11 million – no developer would build a project with these economics.

ASC for the Former Kings Site (continued)

- Based on the projected rents and expenses, the completed 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 payment, 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 Owner Investor	<u>3,221,221</u>
Dollars Available for RE Taxes	330,279
PILOT as a % of Collected Rents	7.72%
<u>PILOT Calculation</u>	
Construction Cost	56,512,645
Net Income	3,551,500
PILOT Payment at 10% of Collected Rent	<u>-427,630</u>
Return to Owner Investor	3,123,870
Rate of Return	5.53%

Township Revenue Analysis

PILOT Comparison	Payment	Township Share	Township Revenue
Conventional Taxes	\$973,167	19.12%	\$186,070
PILOT @ 10.0% AGR	\$427,630	95.00%	\$406,249
Difference	-\$545,537		\$220,179

- If conventionally taxed, the 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; and
 - Annual tax revenue to the Township increases by 118%.

Why an ASC for this Property?

- Produces a financially feasible project that meets the Township's design standards.
- Generates more tax revenue to the Township than the current assessment (\$406,249 v. \$56,157)
- Allows the Township to dictate the project's size, height, architectural elements and number of units
- PILOT payments increase as rents increase
- Helps the Township meet its affordable housing requirements