

Overview of Annual Service Charges (or PILOTs) for the 100 Locust Avenue Redevelopment Project



October 10, 2017

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.

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 property or project while paying Annual Service Charge.

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.

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 100 Locust Avenue

- Following a review of the proposed Redevelopment Project's construction, revenue and expense financials, the Township's professionals have concluded that, "but for" an ASC, the proposed Redevelopment Project at 100 Locust Avenue would not be economically feasible.

<u>Market Value Calculation</u>		<u>Development Cost</u>	
Projected Collected Rent	\$4,537,428	Land/Improvement Costs	\$10,093,800
Operating Expenses Before RE Taxes	970,200	Soft Cost/Development/Finance	7,503,379
Net Income	<u>\$3,567,228</u>	Construction Budget	<u>33,152,625</u>
<u>Return Requirements</u>		Total Development Cost	\$50,449,804
Owner/Investor	5.70%	Market Value Upon Completion	<u>45,442,395</u>
Effective Tax Rate	<u>2.15%</u>	Gap (Loss)	<u>\$5,007,409</u>
Total Rate of Return (Cap Rate)	7.85%		
Projected Market Value (No PILOT)	\$45,442,395		

ASC for 100 Locust Avenue

(continued)

- Development costs exceed market value by over \$5.0 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 for 100 Locust Avenue (continued)

- Based on the projected rents and expenses, the completed Redevelopment Project will generate \$3,567,228 in net income before real estate taxes.
- The URE has agreed to a 13% ASC, thus reducing their return on equity to \$2,977,362 or 5.86%.

PILOT Calculation

Construction Cost	50,449,804
Net Income	3,567,228
ASC Payment at 13% of AGR	-589,866
Return to URE	2,977,362
URE Return on Equity	5.90%

Township Revenue Analysis

PILOT Comparison	Payment	Township Share	Township Revenue
Conventional Taxes	\$977,735	17.61%	\$172,179
PILOT @ 13.0% AGR	\$589,866	95.00%	\$560,373
Difference	-\$387,870		\$388,193

- 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 Township increases by 225% over conventional taxation.

Financial Agreement Terms for Proposed Redevelopment Project

- Term is the earlier of 30 years from Redevelopment Project completion or 35 years from execution of Financial Agreement.
- ASC equal to greater of:
 - 10% of Annual Gross Revenue; or
 - 20%/40%/60%/80% of conventional taxes.
- Minimum Annual Service Charge = \$102,791 (total taxes paid on property in prior year).

Financial Agreement Terms for Proposed Redevelopment Project (continued)

- Land and Improvements are exempt from conventional taxes.
- ASC paid quarterly like conventional taxes.
- Township annual Administrative Fee equal to 2.0% of ASC.
- Upon expiration of Financial Agreement, Redevelopment Project pays conventional taxes.

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 (\$560,373 v. \$18,410).
- Does not preclude allocation of a portion of ASC to School District to cover increased costs (if any) attributable to the Redevelopment Project.

Why an ASC for this Property?

(continued)

- Allows the Township to dictate the project's size, height, architectural elements and number of units.
- ASC payments increase as rents increase.
- Helps the Township meet its affordable housing requirements.