

## MEMORANDUM

To: Borough of Dunellen

From: McManimon, Scotland & Baumann, LLC

Date: March 24, 2022

Re: Tax Exemptions and Abatements Under the Five-Year Exemption and Abatement Law (the "Act")

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This memorandum addresses the questions raised by the Borough in connection with a proposed five-year exemption and abatement program. At the Borough's request, we previously prepared a form of ordinance authorizing the five-year exemption and abatement program, along with a memorandum summarizing the terms of same. The Act provides the Borough with discretion on which elements of a five-year exemption and abatement program the Borough chooses to implement. The draft ordinance we prepared made assumptions as to what type of program the Borough may want to offer and can be tailored and revised to reflect the decisions made by the Borough. In order to assist the Borough in making these decisions, we have set forth below the Borough's questions along with our responses.

- 1. How does the Tax Assessor administer the abatement and/or the exemption? In practice, how time consuming or arduous is this task? To elaborate our concern, if there are 15 properties granted tax abatement/exemption, how much time will the Tax Assessor be spending on them, after the initial ordinance is adopted?**

The implementation of the abatement and/or exemption cannot efficiently be conveyed in this Memorandum. We suggest we schedule another call similar to our call on March 2<sup>nd</sup> to address this question in particular. We will ask our partner, who is also a tax assessor, to participate in that call.

- 2. We presume the ordinance is adopted by Council. Who prepares the ordinance and does the \$1,500 fee go directly to the preparer, or just a portion?**

Each property ordinance is adopted by the Borough Council. MS&B will prepare each ordinance. The \$1,500 application fee is paid to the Borough. The Borough can use the application fee to pay the cost of preparation of the ordinance and retain the balance for any lawful use.

- 3. The ordinance does not have \$5,000, \$15,000, or \$25,000 limits, but the memo does in reference to residential properties. Where do these numbers come from and do they also apply to other categories?**

Section 5 of the Act permits the Borough, within each ordinance approving a residential exemption, to regard the first \$5,000 or \$15,000 or \$25,000 of value of improvements as not increasing the taxable value of the property for a period of five years. In other words, the three amounts are set by statute but the Borough determines in the ordinance that implements the program which exemption amount will be applied. This exemption amount is only available to residential dwelling units that are more than 20 years old, which can include other structures on the property (detached garage) and also includes condominium or cooperative residential units. Section 115B-5A(1) of the form ordinance provides a cap of \$25,000, but that amount can be set at \$5,000 or \$15,000 at the Borough's discretion.

**4. What is the Construction Official's role in the process? Should they participate in some way (as in determining with the Assessor the value of the improvement, e.g.)?**

The Construction Official will certify the improvements as complete through issuance of a Certificate of Occupancy, which then triggers the commencement of the exemption and/or abatement. The Borough can determine how the Tax Assessor and Construction Official coordinate their efforts.

**5. The ordinance has: "the annual payment to the Borough in lieu of full property tax payments." Is this a PILOT? Or by the ordinance and agreement with the developer, is this payment agreed to and set and is somehow separate from the annual property taxes, but is not formally/legally a PILOT?**

The term "PILOT" is neither a legal term nor does it appear in the Act or in the Long Term Tax Exemption Law. It is an acronym for "payment in lieu of taxes" used by practitioners. The Act and the ordinance permit property owners in certain circumstances to pay to the Borough "in lieu of full property tax payments" an amount computed as set forth in the Act and ordinance. Such payment would be considered a PILOT by nomenclature.

**6. Within the ordinance what's the difference between dwellings and multiple dwellings? Should a definition be added explaining the difference?**

A dwelling is a single residential property, as opposed to a commercial property. A multiple dwelling has more than one residential unit, such as a two family (or more) property. Both terms are defined in the Act. We can repeat those definitions in the ordinance if the Borough chooses.

**7. Is the maximum exemption for residential improvements \$25,000? Can it be more, or less?**

Under Section 5(a) of the Act, the maximum exemption for residential improvements is \$25,000. As set forth in question 3 above, it can be less (\$5,000 or \$15,000). Of course, as a general matter, in any case, the exemption can't exceed the lesser of the exemption limit determined by the Borough in the ordinance and the value of the improvements.

Further, Section 5(c) of the Act, allows for exemptions of some portion of the assessed valuation of construction of new dwellings or conversions of other buildings to dwellings. The percentage of the valuation to be exempt is set by the Borough via ordinance and cannot exceed 30% of the assessor's value of the dwelling constructed or conversion made. Depending upon the cost of the construction of the new dwelling or conversion and the percentage determined by the Borough, the exemption could exceed \$25,000.

Lastly, if the Borough chose to enter into a tax agreement under Section 10 of the Act, then the exemption could be calculated on a cost basis using 2% of the cost of the project, or on a gross revenue basis using 15% of the gross revenue of the project, or on a phase-in basis using percentages of the taxes otherwise due. Depending upon the details of the project, any one of these three calculations could result in an exemption that exceeds \$25,000.

8. **In the preamble of the draft ordinance, 3rd "Whereas" clause, it is stated that the Borough has determined that authorization of tax exemptions and abatements for improvements to, and new construction of, various designated structures is in the best interests of the Borough. Two questions: 1) has the Borough already made that determination in other legislation, or is that a statement referring to this piece of legislation? 2) Should additional language be added in here to specify that this particular determination by the Borough pertains strictly to the designated area in need of redevelopment (aka Rehabilitation Area)?**

The Borough has not made the "best interest of the Borough" determination in other legislation. The statement is referring to the determination being made by the ordinance itself. Generally, the ordinance only applies to the Borough's designated areas in need of rehabilitation and areas in need of redevelopment. The ordinance and, as a result, the determinations made therein, do not apply to properties located outside such rehabilitation and redevelopment areas

9. **§115B-4A(1): Is the same amount of work involved for the assessor regardless of the type of exemption / abatement application? If not, the application fee for each type should reflect the relative amount of work involved; (similar question as to §115B-4B(1) – is the same amount of work involved for new construction as it is for improvements?**

The Tax Assessor's workload should be similar for all types of applications. That said, the Borough may set the application fee at any amount it chooses and may also revise the fee if it determines at a later date that a higher amount is warranted.

10. **§115B-4B: What sort of "change in circumstance" would exist to permit the developer to make an application (albeit late) for the exemption / abatement? It would seem that this language would essentially nullify the requirement of submission of application prior to commencement of construction.**

The "change in circumstance" addresses a significant change that effects the project financials such as cost increases like many developers are currently experiencing.

11. **§115B-4B(3). I would suggest slightly modifying language to, “ Exemptions and/or Abatements for Construction or new Construction of Multiple Dwellings, Commercial Structures, or Industrial Structures shall be granted or denied by the Borough Council on an individual basis after review and evaluation of each application and consideration of the recommendation by the Assessor to the Borough Council.” These modifications would clarify that the Borough Council can make whatever decision it deems best, even if that decision is counter to the recommendation of the Assessor. Otherwise, there really would be no need for the Council to be involved as set forth in this section.**

We will make these revisions.

12. **How many different properties are affected by this ordinance? Has anyone projected the relative values of loss of revenue for new construction or construction fees for improvements, as well as tax basis gained, versus value of converting blighted properties to municipal benefits?**

In theory, every property located within an existing rehabilitation or redevelopment area could participate in this program. That said, and as discussed in our original memorandum, the Borough gets to determine the scope of the program, which will further impact the number of properties eligible.

We are not aware of any analysis undertaken by the Borough or its financial consultants to forecast the economic impacts of the proposed program. As a general matter, there are two things to consider. First, the Borough should see an increase in construction permit fees resulting from the program. Second, if the Borough were to limit the program to exemptions, it is not "losing" any existing tax revenue. The Borough is simply forgoing what would have been new, additive tax revenue for 5 years.

13. **Also, does this ordinance have any retroactive applicability to any existing redevelopment projects? (And, to the point above, can an existing project have a developer invoke the “change in circumstance” language to gain the benefit of this ordinance, should it be implemented?)**

No, this ordinance and the program established by the ordinance does not have retroactive applicability to any existing redevelopment projects. The Borough's existing redevelopment projects are being taxed pursuant to the Long Term Tax Exemption Law, which provides more benefits to the redeveloper (and the Borough) than this proposed program would.

14. **§115B-5A(4) How was the percentage (30%) selected? What is the basis? And since we do not understand the significance of an abatement versus an exemption even after reading the explanations of the same in the legal memorandum, what sort of impact does a 30% abatement have on a property’s taxability (as opposed to the assessed value realized before redevelopment)?**

The Borough may choose any percentage up to 30% for the abatement amount. The statutory distinctions between an abatement and an exemption are admittedly confusing. An exemption is akin to a forbearance of the new taxes that the Borough would otherwise have collected as a result of the improvement constructed. Let's assume an existing residential property has an assessed value of \$350,000 and the property owner completes new improvements that add \$25,000 to the assessed value. An exemption essentially ignores the \$25,000 in new assessed value for a 5-year period. The property owner pays taxes on the assessed value of \$350,000, and not \$375,000. While the Borough is not getting the new taxes on the \$25,000, it also isn't losing tax revenue that it was receiving pre-improvement. In other words, the exemption is revenue neutral to the Borough. An abatement is a reduction of the pre-improvement assessed value of the property. As a result, an abatement would reduce the amount of tax revenue the Borough currently receives from the subject property.

**[15. was omitted in the initial memorandum]**

**16. Is the Application fee non-refundable?**

Yes.

**17. All Exemptions and/or Abatements shall be recorded and made a permanent part of the official tax records of the Borough, which record shall contain a notice of the termination date thereof.**

- a. How recorded?**
- b. How permanent record?**
- c. How notice**

The exemptions and/or abatements are recorded in the Tax Assessor's office on the Tax Assessor's property tax records.

**18. \$500 plus \$1500, and an ordinance**

Property owners seeking an exemption and/or abatement for new construction of multiple dwellings, commercial or industrial structures will need to provide an application fee of \$500 and establish an escrow in the amount of \$1,500. An ordinance is only needed in the event the Borough chooses to enter into a tax agreement.

**19. 115B-4(A)(4) same as 115B-4(B)(5)**

Section A. addresses improvements or conversions of multiple dwellings, commercial or industrial structures. Section B. addresses new construction of multiple dwellings, commercial or industrial structures.

**20. 115B-7 any exemptions and/or granted hereunder**

That provision should read "any exemptions and/or abatements granted hereunder". We will revise accordingly.

**21. Can the Borough require facade improvement standards should these incentives be requested on such improvement?**

The Borough cannot impose facade improvement standards as a condition of granting an exemption or abatement. However, if the Borough wants to explore facade improvement standards as a general matter, that can be done in accordance with applicable law.

If you have any questions, please do not hesitate to contact us.