

Preparing for the Tax Increment Financing Program

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With new TIF provisions in place, the question remains: Will people agree that public funds should be used to pay for certain projects?

By Dennis Scardilli

After I drafted my first appraisal, my father, who was also my employer, gave me some advice that has withstood the test of time: "Now that you are finished with all of your technical analysis, go sit down on the curb across the street from the property and ask yourself, 'what would someone really pay for it?'"

If state government uses the same common sense approach, the majority of New Jersey's citizens will be able to look at redevelopment projects funded under New Jersey's new provisions for "tax increment financing" (TIF) and agree that it made sense to use public funds to help pay for them.

The relevant New Jersey statutes are the Redevelopment Area Bond Financing Law (Section 1 through 10 of P.L.2001, c.310; N.J.S.A. 40A:12A-64 et seq.; the "RAB law") and the Revenue Allocation District Financing Act (Sections 11 through 41 of P.L.2001, c. 310, N.J.S.A. 52:27D-459 et seq.; the "RAD law").

The RAB and RAD laws were discussed at a recent presentation on Redevelopment Law conducted by the New Jersey State Bar Association's Institute for Continuing Legal Education. Institute speakers outlined several challenges that will be faced by the board in first establishing the process for, and then conducting a review of, applications under those laws.

This article focuses on the primary role of the board to make certain that this process results in fiscally sound decisions, adheres to the detailed approval process set forth in the legislation and includes linkages between the proposed Redevelopment Project and New Jersey's Smart Growth poli-

cies. (See the Department of Community Affairs and ICLE proceedings.)

In the RAD law, The New Jersey Economic Development Authority (NJEDA), municipal redevelopment agencies and county improvement authorities are among the authorized organizations eligible to be a "district agent," the "entity designated by the municipal governing body ... to administer a revenue allocation plan on behalf of the municipality." N.J.S.A. 52:27D-461.

Under both laws, a district agent has the authority to incur debt and issue bonds and other obligations." See N.J.S.A. 40:12A-65 and N.J.S.A. 52:27D-468e, respectively, for RAB and RAD laws.

RAB and RAD projects first require the establishment of a redevelopment area or district. The RAB law addresses projects in which there is a predetermined Payment in Lieu of Taxes (PILOT) or Special Assessment. N.J.S.A. 40A:12A-66a, 66b. Under the RAD law, the marginal real estate tax revenues flowing from the redevelopment would be directed to the payments on bonds issued to fund various aspects of the redevelopment project. N.J.S.A. 52:27D-468e.

Feasibility Test

The RAD law requires the local finance board (the board) in the (DCA) to reach a determination that, "the planned developments are likely to be realized and would not likely be accomplished by private enterprise without the creation of the district and the revenue allocation financing of the proposed project." N.J.S.A. 52:27D-464. This provision is referred to as the "but for" test.

Further, under both laws, the board conducts a statutorily specified review and solicits comments from the DCA Office of State Planning (now the Office of Smart Growth), NJEDA and the public.

The board and the Office of Smart Growth are now in the early stages of developing an application and procedures for the RAB/RAD laws. See generally, Redevelopment Law Institute Materials, New Jersey Institute for Continuing Legal Education (NJICLE), p.6-7. New Jersey Department of Community Affairs, NJICLE Redevelopment Law Institute, Jan. 15, 2004.

While Tax Increment Financing is new in our state, over 40 states have various types of TIF programs already in operation, including California, Minnesota, Florida, Texas and Pennsylvania.

The board's process must address a variety of considerations in making its decision on an application. The board's must consider what has become known as "smart growth" criteria under RAB, including "reduc(ing) congestion, enhancing mobility assisting in ... redevelopment ... and ... improving the quality of life." N.J.S.A. 40A:12A-67g.

Under RAD, the other key issue before the board at this time is how to create a regulatory mechanism to implement the statutorily-required but for test. N.J.S.A. 52:27D-464a. That law effectively adds a feasibility test to the statutory language of the RAB law.

Application review under RAD must result in a reasonable determination that the proposed project meets smart growth criteria, will create otherwise unavailable redevelopment opportunities, and will not impair the municipality's finances. N.J.S.A. 52:27D-464a-g.

The but for test is generally thought to be quantitative. Project A has a gap of \$20 million between funding from all other sources and project cost. Valuation/market study experts, including the municipal tax assessor, agree that it is reasonable to project an increase in ratables under the RAD law that would support project-related

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bonds totaling \$20 million dollars.

In this scenario, the project appears to meet the but for test under the RAD law. Under RAB, the statute appears to assume that the PILOT or Special Assessment has been calculated to have the same effect. Both the RAB and RAD laws have a subjective review provision that can reasonably be based upon public policy determinations. (52:27D-464h under RAD mirrors N.J.S.A. 40A:12A-67g.)

The board's policy guidance for RAD/RAB applications should combine legal, public policy and practical considerations:

- (i) create reasonable and well-documented models for the relevant legal, policy and financial feasibility tests;
- (ii) produce clear guidance materials on the required content of applications and on procedures for review; and
- (iii) provide for comprehensive training for both those preparing the application and those reviewing it.

In all of these elements, the process and the policy must be transparent, relevant and practical. For example, a RAB/RAD public-private stakeholder task force could be used to create legal, policy and financial feasibility tests. Such guidance could be posted on the DCA Web site, downloaded to a word processing program and used by municipal and developer professionals to determine if a proposed project will meet the three-pronged review, even before board review.

Financial Test

The financial test may be the most problematic. Since this is a new concept in New Jersey, bond underwriters may initially find good deals to be few and far between. A high degree of confidence among bond underwriters and investment brokerages could be engendered through the board's adoption of "market-based underwriting criteria."

Determine what is needed to create a deal on which an investment banker will bet the farm. Then, identify bottom line policies, including any clarifications to the legal tests set forth in the statute.

Communicate these rules to the

players, including attorneys, planners and elected officials. Give them a clear understand what is required to get a RAB/RAD application approved by the board.

Perhaps the most difficult issue to address will be estimating the resulting marginal increase in real property tax revenue cash flows at project stabilization.

Let's say that Project B has a present tax base of \$5 million in real estate tax revenues before the redevelopment project takes place. Bond underwriters tell the municipality that a range of an additional \$5 million is required to carry the bonds that would be sold to build the project.

The issue before the board will be to determine the validity of the municipality's post-completion/rent-up assessed value estimate supporting the necessary assessments.

While this is a prospective aspect of RAD projects, it is a precontractual aspect of a RAB project, so similar analyses must occur. Such analyses will require expert real estate appraisers to not only make well-supported estimates of "after redevelopment" values (RAD) or cash flows (RAB), but, to also quantify the effects of Smart Growth policy linkages under both laws.

For example, can higher rents be obtained for office space in a proposed town center by creating a commuter rail stop, than in one without such an amenity? Further, the state has been focusing on ensuring coordination between state regulatory agencies to ensure development projects are aligned with Smart Growth policies. We can expect the board's review will also include analysis of project compartment with these policies.

Art or Science?

Because market value estimates under such assumptions may be arguably more art than science on any given project, an appraiser's value estimate must be clearly based on empirical evidence to support their conclusion, perhaps even requiring a national search for such market evidence.

Market studies must also be created with these same factors in mind. To control for the inevitable human factor in such an art, particularly for the first

several projects, at least two appraisals and market studies should be the norm, as was the case with certain high dollar-value Green Acres projects, such as the conservation of the undeveloped part of Cape May Harbor. Appraisal/market studies should be reviewed by a truly independent expert with knowledge of the specific market.

Any financial market concerns regarding the dollar value of policy linkages may require certain projects to either self-insure through atypical reserves, through use of bond insurance or through other collateral enhancements, such as mortgage or environmental insurance. Establish a mechanism for periodic feedback from market participants to determine where adjustments need to be made, and make them.

Policy Viability

In addition to the but for test, municipal officials, developers and their professionals will need to know exactly how to assess the policy viability of a project so that municipal officials can take such policy criteria into account in designating viable Redevelopment Areas.

While legal tests are clearly set forth in the statutes, it will be necessary to establish clear understandings among state government agencies on any required or "encouraged" public policy criteria and linkages. Establishment of those policies and linkages will guide municipal officials in making redevelopment area/district determinations, which are now being sought by owners and developers.

Above all, apply common sense in the creation of an application process that will balance the requirements of real estate development underwriting and the necessities of public policy implementation.

After the proper techniques and doctrine have been applied, the final determination must be able to withstand the scrutiny of the average citizen sitting on the curb across the street from the project and asking, "did it really make sense to use public funds to pay for this project?"

I believe that it is possible to have the vast majority respond with a resounding "Yes." ■