

State of New Jersey

Office of the State Comptroller

A. Matthew Boxer, Comptroller



A Programmatic Examination of

Municipal Tax Abatements



State of New Jersey

OFFICE OF THE STATE COMPTROLLER
P.O. Box 024
TRENTON, NJ 08625-0024

CHRIS CHRISTIE
Governor
KIM GUADAGNO
Lt. Governor

A. MATTHEW BOXER
State Comptroller

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The Honorable Christopher J. Christie
Governor of New Jersey

The Honorable Stephen M. Sweeney
President of the Senate

The Honorable Sheila Y. Oliver
Speaker of the Assembly

Residents of the State of New Jersey

This report reviews the usage of redevelopment and rehabilitation tax abatements by New Jersey municipalities and provides recommendations for improvements.

This study was undertaken to examine broad issues underlying tax abatement policy and implementation and to inform taxpayers about this complex development tool. We analyzed available data, reviewed relevant standards and obligations, conducted survey interviews, and assembled secondary research to develop findings about selected abatement practices. Our objective was to pull together disparate information and ideas, identifying weaknesses in the system. While specific agencies or municipalities received attention in our review and sometimes are mentioned directly, the purpose was not to document a particular failing but illuminate vulnerabilities or questionable circumstances that call for greater accountability and transparency.

Tax abatements result in significant foregone revenue and introduce tax inequities that deserve closer scrutiny. The recommendations in this report are geared toward broad-based changes that will help to ensure more open and fair investment of taxpayer dollars and better decisions and outcomes in the future.

A. Matthew Boxer
State Comptroller

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Executive Summary

Each year in New Jersey, municipal governments forego hundreds of millions of dollars in revenue through reductions of or exemptions from taxes in the name of economic and community development. Referred to as tax abatements, these exemptions are granted typically to businesses and developers to encourage them to make improvements to property or to locate a project in a distressed or blighted area. The impact of such abatements is significant and far-reaching and the financial stakes are high, involving billions of dollars in New Jersey property value. Despite these high stakes, in New Jersey little is done to monitor the use of such abatements, to ensure that they are appropriately awarded, or to determine whether they achieve their purposes.

Our review of tax abatement practices in New Jersey found numerous weaknesses in the regulation, implementation, and oversight of these programs, including:

- Payments to municipalities by businesses and developers in lieu of taxes, known as PILOT payments, distort municipal incentives in using and structuring abatements at the expense of counties, school districts, and other taxpayers.
- Information concerning abatement agreements is not published in a transparent manner or centralized location, making it difficult to impossible for the public to compare, calculate the effect of, or be fully aware of those agreements.
- Many of the municipal criteria and processes used in evaluating potential abatement agreements are weak.
- Directly affected stakeholders are not involved adequately in the abatement decision-making process.

- Municipal follow-up on abatement terms and benefits generally is lacking, impeding accountability and feedback.
- Redevelopment areas in which abatements may be granted typically are not periodically reviewed to account for neighborhood changes or improvement.
- Municipalities often fail to use abatements to bring in the type of redevelopment that would address community needs or bring appropriate improvement.
- The state does not closely monitor the use of abatements or offer significant guidance to municipalities on how to interpret relevant statutes or implement abatement programs.

The tax abatement tool is a complicated one, the benefits of which should be measured and analyzed. Tax abatements should be used carefully and sparingly given the multitude of pitfalls, their far-reaching impact, and the reality that exemption from taxation is a departure from the normal allocation of tax obligations. While community development and improvement are obviously desirable goals, public officials should ensure that appropriate analyses are undertaken before presuming that abating taxes is the optimal means to accomplish these goals.

Programmatic improvements are necessary in New Jersey to safeguard public finances and ensure that the developmental goals of the abatement program are actually reached. Specifically, as explained in this report, we recommend:

- Counties, school districts, and the public should assume greater roles in the abatement process.
- PILOT arrangements should be structured in a way that encompasses the interests of counties and school districts.

- A thorough cost-benefit analysis of community impact should be undertaken before awarding an abatement.
- Strong criteria and processes should be set forth up front in local ordinances to ensure that abatement applications adhere to appropriate standards to receive approval.
- Periodic reviews and reclassification of areas "in need of redevelopment" should be instituted.
- Applications for abatements should be due before project construction begins.
- Local tax listings should clearly identify redevelopment and rehabilitation abatements to promote transparency and permit proper review.
- Periodic municipal review and follow-up concerning developer performance should be required after an abatement is awarded.
- The state should maintain, compile, and make available to the public records concerning tax abatement policies and practices in New Jersey.
- The state should provide enhanced and increased guidance to municipalities on granting and implementing tax abatement agreements.
- The state, through the Local Finance Board in the Department of Community Affairs, should actively review municipal abatement practices and choices, particularly with regard to high-value agreements.

Introduction

Community growth and progress are reliant on economic development, particularly in distressed or blighted areas. Private-sector investments in a community can revitalize an area by bringing jobs, residents, and business activity, as well as potential increases in property values and, ultimately, tax revenue. Yet, attracting businesses and investment to areas most in need of redevelopment or rehabilitation is often difficult.

Tax abatements are used with the intention of attracting such investment. Tax abatements are reductions of or exemptions from taxes granted typically to businesses and developers to encourage them to make improvements to property or to locate a project in a distressed or blighted area. In New Jersey, municipalities grant tax abatements to enhance employment opportunities, attract residents, and lure commercial establishments, while developing vacant or underutilized property. In view of comparatively high property tax rates in New Jersey, abatements can be a valuable incentive for developers, involving hundreds of millions of dollars in abated taxes on billions of dollars of property across the state.

While abatement of taxes otherwise owed is uniformly positive from the perspective of the developer, it results, at least in the short term, in lost revenue for government entities. In addition, these financial arrangements can create tax inequity and present opportunities for unfair favoritism or cronyism. Given these concerns, municipalities' use of abatements warrants scrutiny, particularly in ensuring that the abatement of taxes actually is necessary to spur the property owner's investment.

This report analyzes local abatement practices in New Jersey to develop a broad view of this complex area, identify areas of weakness, and determine opportunities for improvement. The report is an overarching and general analysis of municipal tax

abatements, undertaken with the goal of determining whether programmatic improvements or legislative changes would be appropriate. It was conducted in accordance with *Designing Evaluations* guidance issued by the U.S. Government Accountability Office.

The first section of the report takes a general look at abatements, i.e., their structure, advantages they offer to government units, and their potential pitfalls. The report then examines abatement practices in New Jersey specifically. It looks at state efforts to monitor and guide local abatement practices. Then it looks at use of abatements by municipalities themselves, analyzing abatement practices in those municipalities that records indicate are most frequently using the abatement tool. Lastly, the report identifies best practices from other states and other sources, culminating in recommendations for improvement in New Jersey.

Structure and Effects of Tax Abatements

A. Legal Background

While New Jersey law authorizes multiple types of tax abatements, this report focuses on the two types of abatements designed to carry out the community redevelopment and rehabilitation goals of the Local Redevelopment and Housing Law, N.J.S.A. 40A:12A-1 et seq. These abatement types include specifically the Five-Year Exemption and Abatement Law, N.J.S.A. 40A:21-1 et seq., and the Long Term Tax Exemption Law, N.J.S.A. 40A:20-1 et seq. Both of these abatement statutes have their origins in authorizing language in the New Jersey State Constitution itself.¹ They encompass residential, commercial, and industrial properties. For purposes of this report, unless indicated otherwise we use the term “abatement” to refer to tax exemptions granted under either of these two statutes.

The Five-Year Exemption and Abatement Law generally concerns rehabilitation of particular buildings and structures, with an abatement period that lasts no more than five years. These so-called “short-term” tax abatements can be structured as reduced property tax bills that exclude all or part of improvement value or as payments in lieu of taxes (PILOTs). Procedurally, a municipality must first adopt an ordinance invoking its five-year abatement authority and setting out application procedures. This ordinance, referred to as the general ordinance, defines the eligibility criteria, which may include types of structures, types of permissible improvements, as well as qualifying geographic zones or similar designations.

Defining eligibility requirements in the general ordinance provides the most meaningful mechanism for local control over short-term abatements. Unlike the Long Term Tax Exemption Law which gives municipalities broad discretion in deciding

which applicants are entitled to receive abatements, the Five-Year Exemption and Abatement Law leaves little room for such discretion. An applicant merely must satisfy all of the criteria in the statute and general ordinance to be entitled to approval. Applications for individual short-term abatements are presented to the local governing body and must include a general description of the project, plans demonstrating the structure of the project, a statement of reasons for seeking the abatement, claimed benefits to be realized by the applicant if the application is approved, and a statement of taxes currently being assessed and taxes to be paid during the period of the abatement. The application is approved by an ordinance authorizing execution of a tax agreement.

The Long Term Tax Exemption Law is more focused on broader areas of redevelopment. It allows for a longer abatement term to carry out a larger development plan through declaring an area as being “in need of redevelopment.” These long-term abatements may last up to 30 years from completion of a project or 35 years from execution of the financial agreement. The process is initiated when the municipality passes a resolution calling for the municipal planning board to study the need for designating an area “in need of redevelopment.” Upon adopting the planning board’s recommendations and formalizing the redevelopment area designation, a municipality adopts a redevelopment plan, engages redevelopment entities to carry out the plan, and may authorize long-term tax abatements in the process. Developers submit abatement applications to the governing body for review. The financial agreement ultimately is approved through adoption of a local ordinance. The agreement exempts a project from taxation, but requires payment of a PILOT in an amount based generally on a percentage of project costs or revenue generated by the project, depending on the type of project.

For both types of abatements, municipalities are able to abate portions of property taxes that otherwise would be paid to the municipality as well as to other entities such as counties and school districts. These other entities, however, are not afforded a statutory role in the designation of redevelopment areas, the approval of redevelopers, the selection of projects, the decision to award an abatement, or the formation of the financial agreement. In the case of short-term abatements, the tax loss resulting from the abatement agreement is proportional across the municipal, county, and school district levels. In the case of long-term abatements, the tax losses fall more dramatically on counties and schools. Specifically, under the long-term abatement statute, the county receives 5% of the PILOT (a percentage that yields substantially less than the ordinary tax structure) and the local school district does not receive any portion of the PILOT.²

B. Effects of Abatements

Abatement laws are intended to improve local conditions and spur economic development that otherwise would not occur, and are valued by many municipal leaders as an important tool for redevelopment. This report attempts to add to the discussion surrounding economic development incentives generally and tax abatements specifically by identifying a number of unintended effects and negative outcomes that can result from such abatements.

In the broadest sense, tax abatements are meant to encourage rehabilitation and redevelopment of distressed areas. For example, the Long Term Tax Exemption Law explains that the goal of abatement laws is “the restoration of deteriorated or neglected properties to a use resulting in the elimination of the blighted condition.”³ Similarly, as one township’s website has observed regarding the Five-Year Exemption and Abatement Law, it is meant to

“encourage new commercial and industrial development, thereby, increasing the commercial ratable base, whereby, alleviating some of the tax burden from the residential property owners. Additionally, new commercial and industrial development will create job opportunities within the municipality.”⁴ Such tax incentives can serve as tipping points for potential private-sector investment that is critical to successful community rehabilitation or redevelopment. That is, tax abatements can offer financial incentives that make beneficial development possible.

The potential benefits of abatements include additional short and long-term employment for local residents, attracting new businesses or improving existing businesses, luring new residents which in turn can generate additional tax revenue, generating a tax-revenue stream on once vacant or underdeveloped property, improving safety and commerce, and increasing adjacent property values. A recent publication by one New Jersey municipality touted many of these benefits, stating that “abatements are granted to projects that increase the city tax base, redevelop underutilized property, create jobs and improve . . . housing stock.”⁵

However, abatement programs can also create inequities and the potential for waste and abuse. The inequities stem from shifting tax burdens, while the potential for waste and abuse lies in the process of choosing developers and projects.

For example, as noted previously, under long-term abatement arrangements property tax collections on the development – which normally are split among several entities – are eliminated, and 95% of the negotiated PILOT is kept by the municipality, with 5% for the county and nothing for the school district. In many cases, the negotiated PILOT provides more funds to the municipality than it would have otherwise received, while the other government entities receive less. This system distorts the costs and benefits of an abatement deal, as municipalities

may receive greater funds while other entities, particularly school districts, absorb costs.

PILOTs also shift the tax burden among regional and local taxpayers. Governing bodies set tax rates to provide a certain level of revenue for operating expenses. If selected properties are exempt from taxes, then any necessary revenue must be obtained from the remaining tax base. Thus, tax abatements may raise the tax rates for those not receiving abatements by removing a previously paying ratable (i.e., a taxable property) from the tax rolls, or by exempting a new development that could have paid taxes or that imposes extra costs on local government entities. The imposition of a PILOT may offset this shift of tax burdens within a municipality; however, PILOTs do little to help other local entities reliant on tax revenue, such as counties and school districts.

Cronyism may emerge in the approval process of long-term abatements, further compounding these inequities. Cronyism provides unfair advantages to favored developers and, in the process, can lead to less beneficial terms for the municipality and other affected parties. Historical evidence of corruption of the redevelopment process in New Jersey confirms that this threat is real in the long-term abatement context.⁶ Similarly, inappropriate or non-remedial development precludes other options physically and financially, and may result in “rehabilitation” that ultimately is not meaningful or beneficial.

Thus, the positive and negative effects of a particular abatement agreement must be analyzed and weighed in determining whether an abatement is worthwhile and how to structure the abatement for optimal societal benefit.

Importantly, the asserted benefits of granting tax abatements are far from guaranteed. Developers may overpromise benefits that do not materialize. In that regard, a number of studies have cast doubt on whether tax abatements generally attain their desired goals, including whether they actually affect business

expansion, development, and relocation decisions.⁷ These studies indicate that businesses are influenced primarily by other factors such as available workforce, infrastructure, transportation, and financing. While developers sometimes state that abatements were important to their investment decisions,⁸ it is unclear how much credence to give such self-serving statements by those who do not want to jeopardize their current or future tax deals. Where an awarded abatement did not have a strong impact on the underlying investment decision the result is an unnecessary public giveaway for a project already set to occur.

Even in cases where an abatement truly impacts the decision to invest, a different set of potentially negative outcomes arise. The receiving firm may be or become dependent on the incentive for profit or viability. As a result, when the abatement expires, the firm may require a renewed abatement (if it has not already exceeded statutory limitations) or it may leave the community, risking a termination of some or all beneficial gains.⁹

Meanwhile, the cost and burden-shifting effects are real. At least in the near term, and at least for some entities, tax receipts are lost. At the same time, new development may increase the amount and types of government services being demanded. Compounding the issue, the ability to obtain PILOTs creates a “moral hazard” for municipalities because they may be shielded from the negative revenue effects of the abatement. While municipalities are incentivized to take greater risk and pursue abatements that may increase their own revenue intake, the costs are pushed onto counties, school districts, other taxpayers, and potentially the state through greater state aid obligations. In instances where the development at issue would have occurred without an abatement, the tax distortions are even more severe.

Overall, while striving to induce investment, tax abatements present a risk of becoming unnecessary

giveaways or incentivizing unsustainable development. As stated in one New Jersey court case and echoed elsewhere, “The general rule in interpreting tax exemptions is that such exemptions are to be strictly construed because an exemption from taxation is a departure from the equitable principle that everyone should bear his just and equal share of the public tax burden.”¹⁰ In determining whether to enter into an abatement agreement, it is important to consider the realistic benefits, the total costs, and other possible means to spur the desired development.

Abatement Practices in New Jersey

To better understand the use of tax abatements in New Jersey specifically, this section first reviews current state involvement in the municipal abatement process. Following that is an analysis of how extensively New Jersey municipalities use abatements. The report then looks at those municipalities that appear to be most engaged in granting abatements, focusing on potentially problematic practices.

A. State Policy and Practice

Based on financial implications alone, the state has a significant interest in monitoring the granting of municipal tax abatements and in ensuring that the system is being administered fairly and effectively. For example, the state has provided substantial aid to municipalities and school districts based on the proposition that local property tax collections are not adequate to fund those entities. Property tax abatements artificially depress the ratable property base and may increase the need for such state aid, at least in the short term. For this reason and others, state laws have established general parameters concerning tax abatements and dictate limitations on their use, such as limitations on the length of time an abatement agreement may span.¹¹ Those laws also require state approval in designating areas “in need of redevelopment.”¹²

Nonetheless, in practice there is essentially no state oversight and monitoring of the granting of individual tax abatements in New Jersey. For example, various state laws require municipalities to send miscellaneous abatement-related documents and information to the Division of Local Government Services (LGS) within the state’s Department of Community Affairs (DCA).¹³ These materials include a copy of the local ordinance approving an

abatement, the financial agreement with the entity receiving the abatement, audits of that entity, and information concerning the total amount of property taxes exempted within the municipality. According to LGS, it receives sporadic yet substantial documentation along these lines from municipalities. LGS explained, however, that these submissions have not been reviewed, monitored, analyzed, or catalogued in recent years due to staffing limitations.

In 2009, DCA adopted a rule to require municipalities to provide additional information concerning each long-term tax abatement project, including the value of the project, the statutory basis for the abatement, and the basis for calculating the amount of the PILOT payment.¹⁴ The rule has not yet been implemented, and so DCA has not yet instructed municipalities to provide this information. LGS collected similar information from municipalities in 2003, but has not done so since that time, again explaining that the delays are due to resource limitations.

These circumstances have resulted in a lack of transparency and accountability regarding the awarding of abatements in New Jersey. Neither the public nor state officials have easy access to information concerning the extent of abatement usage or abatement-related practices in the state’s municipalities. This lack of information inhibits both macro and micro-level comparisons and assessments, and makes it exceedingly difficult for the state or outside observers to determine best practices or to compare the actions of particular municipalities to established norms.

Moreover, the state has offered little in the way of guidance to municipalities concerning the abatement process. DCA’s website contains voluminous guidance and web-links for municipalities on procurement, accounting, ethics, and budgetary issues, and DCA sends out Local Finance Notices memorializing much of this guidance. It has not, however, provided similar instruction concerning tax

abatement issues in recent years. Best practices or similar materials concerning tax abatements are not referenced on-line, and LGS confirmed that it has had minimal involvement with municipalities on abatement-related issues. The website of the Division of Taxation within the Department of the Treasury similarly offers just a few paragraphs of general overview concerning these complicated programs, as supplemented by periodic alerts the division sends to local tax assessors.

In short, there has been minimal state involvement in the granting of individual tax abatements at the local level. As discussed in more detail below, the lack of state guidance or reviews has contributed to a range of different practices among municipalities.

B. Where Abatements Are Occurring

To examine how extensively municipalities are issuing tax abatements, we researched general property tax information that aggregates tax-exempt property by municipality. These compilations, found on DCA's website, contain total property values for each municipality in a variety of categories, including the value of property that is tax-exempt.¹⁵ Those exemptions are split into several categories including public property, schools, churches, charities, cemeteries, "partial exemptions and abatements," and "other exemptions not included in foregoing classification[s]." For purposes of our analysis of development-related abatements, we took a closer look at the latter two categories, where such abatements might potentially be encompassed. While some exemptions that fall within these categories are outside the scope of this report's examination (e.g., hospitals, federally owned property), the size of these two categories relative to the total amount of ratable property in a municipality provides a preliminary picture of where development-related abatements might be a significant part of the ratable property base.

In many municipalities, the amount of property value in the "partial exemptions" and "other exemptions" categories is not substantial relative to overall property value. Specifically, in 2008, 303 municipalities had less than 1% of their total taxable value in these two exemption categories. Approximately one-third of municipalities, 188 overall, had from 1% to 5% of their property value in these two exemption categories. A total of 75 municipalities had granted such exemptions exceeding 5% of total taxable value. We focused on these 75 entities to determine whether development related abatements specifically were the cause of those exemptions.

We found greater detail on the exempt property in these 75 municipalities in tax listings compiled by county tax boards, which are available in a database maintained by the New Jersey Association of County Tax Boards.¹⁶ Although these listings do not offer details of particular abatement agreements, they reflect information regarding the owners, usage, and assessed values associated with the "other exemptions" category, facilitating a determination of which exemptions stemmed from development-related abatements. A similar breakdown does not exist for the "partial exemptions" category. However, the exempt values found in that category generally were very small (in most instances were zero), and thus were far outweighed from a statistical perspective by the "other" exemptions category.

Examination of the detailed property listings for the 75 municipalities showed that most of them engage in few to no redevelopment or rehabilitation abatements of significant value. Of the 75 municipalities, 40 had little to no such activity, with exemptions instead aimed at public properties, medical facilities, or nature preserves. An additional 12 of the municipalities had relatively few development abatements. The records indicated that only 20 municipalities had granted many or high-value abatements for rehabilitation and

redevelopment. In addition, three municipalities did not list information in a manner sufficient to allow a determination as to whether their abatements were development-related. The following 23 municipalities comprise the two groups:

- *Significant Use of Development Abatements:* Asbury Park, Atlantic City, Bayonne, Bridgeton, Camden, Collingswood, Harrison, Hoboken, Gloucester Twp., Jersey City, Long Branch, Millville, Newark, New Brunswick, Paterson, Rahway, South Bound Brook, Vineland, Union City, Trenton
- *Limited Information in County Tax Database:* East Rutherford, Elizabeth, West New York

The small number of these municipalities should not disguise the expanse of the abatement issue. These municipalities are among the largest population centers in the state. In addition, to the extent that abatements contribute to local underfunding of services, additional state aid becomes the burden of all state taxpayers. So while most municipalities are not engaged in large-scale abatements, the fiscal impact from the ones that are can be significant.

Population, location, and income data show that these 23 municipalities vary in terms of demographics, but a few trends emerge:

- Their population ranges from 4,500 to about 263,000, but tend to be densely populated, urban areas, and together comprise approximately 17 percent of the state's total population.
- Five are in central New Jersey, 7 in southern New Jersey, and 11 in northern New Jersey – 9 of which are clustered around the New York City area.
- Median household income ranges from \$23,000 to \$106,000. Thirteen of the 23

municipalities have median household incomes below the national median.

- The percentage of their families living in poverty ranges from 3.3% to 29.3%. Seventeen of these municipalities have family poverty rates equal to or higher than the national and state averages.¹⁷

Urban communities may be tempted to use more aggressive abatement practices to spur redevelopment for a number of reasons. Besides frequently having lower property values to generate revenues from, New Jersey's older, urban areas historically have had a much higher share of exempt properties than their newer suburban neighbors, with a higher number of churches, hospitals, charitable institutions, and government offices that do not contribute to the tax base.¹⁸ Many of these municipalities require significant state revenue assistance and do not have an adequate, sustainable taxable base in attempting to meet their budget needs:

- 16 of the 23 previously received additional state funding for school districts stemming from the New Jersey Supreme Court's decision in *Abbott v. Burke*, 100 N.J. 269 (1985).
- All of the recipients of supplemental state aid known as "Special Municipal Aid" in 2009 and 2010 are among the 23.¹⁹
- 18 of the 23 covered less than half of their municipal costs through local property taxes, and 15 had more than 40% of their local costs covered by state aid in 2009.²⁰

While distressed municipalities may have a more pronounced need to attract commercial activity and incentivize redevelopment, the above data indicates continued revenue problems tying into a depleted ratable property base. Such financial trouble

requiring high levels of state assistance points to the need for careful decision-making associated with the exemption of potentially ratable property.

C. Municipal Practices

We contacted 21 of the municipalities listed above to gather further information on their use of short and long-term abatements, including their reasons for using them, the process of granting an abatement, the taxes and PILOTs collected, and follow-up reviews of granted abatements. We also contacted three counties and three school districts associated with these municipalities to gain their perspectives on how these municipal abatements affect them. Hudson, Camden, and Cumberland counties were chosen because they contained multiple municipalities on the list and because of their geographic diversity. The Asbury Park, New Brunswick, and Hoboken school districts were similarly chosen for their geographic diversity and their diversity in terms of income demographics, though all received additional state funding under the *Abbott v. Burke* designation.

Overall, the use of tax abatements among these 21 municipalities is broad and diverse. Most of the municipalities offer both short and long-term abatements, for purposes ranging from residential to retail to industrial. Ultimately, our inquiries into practices in these locations yielded, on a fairly consistent basis, a number of troubling patterns that jeopardize the benefits of abatements and put taxpayers at risk. Our findings in this regard are set forth below.

I. PILOTs Distort Municipal Incentives

As noted previously, municipalities granting long-term abatements may gain increased revenue from a PILOT arrangement, incentivizing them to pursue abatement deals for monetary gain. Our inquiries confirmed that this phenomenon is prevalent in New

Jersey. Many municipalities we contacted acknowledged that PILOT amounts often exceed the revenue that they would have received under a traditional tax structure. Some officials directly cited this increase in municipal revenue as a motivation to grant abatements.

In this situation, the true costs of awarding an abatement are shielded from municipal decision-makers and are passed on to school districts, other county residents, and state taxpayers. Despite the degree to which county and school district revenue can be impacted, the counties and school districts have no role in the granting process. Under current abatement law, there is no role required of these entities, and none of the municipalities we interviewed actively involved them in the consideration or approval of such abatements. The surveyed counties and school districts themselves confirmed that they are not involved and, typically, not even aware when abatements are granted.

A publicly reported example from the City of Bayonne illustrates the impact numerically.²¹ In November 2009, the city granted an abatement to a power-station project worth a reported \$400 million. It was projected to provide a total of \$45 million in PILOT revenue over 30 years, with 95% going to the municipality. Under a traditional tax structure, the city would have collected \$27 million, and the county and school district collectively would have received even more. From the perspective of the city, the decision to grant the abatement is a somewhat straightforward one – granting the abatement results in a municipal net gain of more than \$15 million. However, the other public entities lose out financially, with the school district receiving nothing and the county only 5% of the PILOT to replace the tens of millions of dollars due under normal tax conditions. Nonetheless, the abatement decision was made entirely by the city.

For counties, the impact is indirect but significant. Abatements artificially depress the ratable property base of a municipality as compared to that of

neighboring municipalities. It is these figures that are used to determine the revenue that the county will require from each municipality. Ultimately, the revenue needs of the county remain unchanged. So, when the county apportions its revenue needs among municipalities, neighboring municipalities will shoulder a larger share of the tax burden and the abating municipality will shoulder less. In other words, the choice of one municipality to abate property taxes and restrict its ratable base raises the tax burden of surrounding municipalities because of the county's unchanged revenue needs.

The burden displaced to the neighboring municipalities can be large. For example, according to the county tax records previously referred to, Jersey City currently exempts approximately \$2 billion of property value. In view of the city's general tax rate of \$6 per \$100 of assessed value (6%), Jersey City is not collecting approximately \$120 million in property taxes on the exempted property. In 2009, Hudson County received approximately 25% of the property taxes collected in the city. Using that as a baseline, the county did not collect approximately \$30 million from Jersey City due to the city's abatements. While the county still receives some amount through its 5% portion of PILOTs, it does not make up for that \$30 million in lost revenue. Instead, the other municipalities in the county make up for those dollars.

Because this burden shifting is indirect, its impact is hidden. The burden is spread among many municipalities, diffusing the magnitude of the costs. County governments themselves typically do not feel the costs of municipal abatements because they collect the same revenue from the group in the end, providing them with minimal incentive to resist abatements or push for more involvement in their approval. Other municipalities see their county contributions increase, but the culprit is not clear. Ultimately, a lack of county policies, involvement, or even awareness of municipal abatements leaves the

neighboring municipalities unrepresented in the process.

Some of this redistribution is offset if other municipalities in the county are also granting tax exemptions that restrict their ratable base. As previously discussed, however, not all municipalities use the abatement tool and not all use it to the same degree. Further, this incentive can lead to a "race to the bottom" in which one municipality's exemptions encourage its neighbors to grant similar exemptions, lowering ratables across the board. Municipal officials have acknowledged the existence of this race to abate in towns as diverse as Millville and Hoboken.²² The result is a decreased ratable property base across the county, adding to the burdens on those taxpayers not receiving an abatement and ultimately affecting the need for state aid.

For school districts, the impact is more direct. School districts often receive a large portion of traditional property tax collections – sometimes more than half. As a result, abatements have a large impact on school funding and the tax burden of other taxpayers in the municipality and the state. When a property tax abatement occurs, the school district receives no portion of the new PILOT revenue and thus loses out on the new wealth of the municipality. Moreover, in some situations the property in question had been generating at least some tax revenue, which may be lost by the school district as a result of the substitution of the PILOT payment. The new development may also add new, unfunded service burdens on the schools. The cost of these burdens must either be absorbed by raising rates on other taxpayers or by paring back services.

State school aid may also be affected. When new development occurs in connection with a long-term abatement, the PILOT revenue is not reflected in its ratable base, meaning formula state aid continues to provide enhanced funding based on artificially low community wealth. The school district still needs

the state aid at the enhanced level since the district itself does not see the benefit of the PILOT amounts, and taxpayers throughout the state pay the resulting bill. This system allows the municipality, in essence, to hide its true wealth from the school district and the state, resulting in the school district's continued reliance on the state for funding.

Again, the financial impact is significant. For example, for the 2009-2010 school year, the Hoboken school district was originally listed to receive \$9.4 million in state aid, later adjusted mid-year to \$8.73 million. Hoboken is listed to receive \$6.99 million for the 2010-2011 school year, a loss of \$1.74 million from last year's adjusted amount. Although the size of the funding decrease is significant, the lost aid actually is substantially less than the amount of school funds uncollected due to local Hoboken abatements. Specifically, based on the local tax listings previously discussed, the value of abated redevelopment property in Hoboken is, conservatively, more than \$298 million. Applying the Hoboken school tax rate of \$1.176 per \$100 of assessed value (1.176%) to this amount yields \$3.51 million in revenue that the school district does not receive as a result of these abatements. That figure is more than twice the state aid cut this year.

2. Location of Property Receiving Tax Abatements

Because of the financial impact of granting property tax abatements, it would seem appropriate to carefully constrict their use, including in a geographic sense. In reality, however, there is substantial flexibility in the location of property receiving tax abatements.

Specifically, in practice statutory requirements concerning granting abatements in "areas in need of redevelopment" or "areas in need of rehabilitation" do not limit tax abatements to the areas most in need. The criteria required to establish such "need"

are open-ended and subject to interpretation. For example, under the Local Redevelopment and Housing Law, an area with a "growing lack . . . of proper utilization" can be one in need of redevelopment; an area may be declared in need of rehabilitation if necessary to "prevent further deterioration."²³ These designations do not ensure that the areas in question are those in the worst condition. As one observer of the process has noted, "[L]ocal governing bodies can – and often do – grant abatements to almost any developer building anything, anywhere."²⁴

Furthermore, there are no clear statutory provisions concerning when a designation of "need" should be removed, or how often designations should be revisited to ensure that improvement over time has not obviated the need for continued abatements. Logic would dictate that some ongoing assessment of progress and necessity should be occurring to ensure that abatements are granted where they are most needed.²⁵ Observers of the redevelopment process in New Jersey, including a former Chief Justice of the state Supreme Court, have noted the problems associated with this absence of a formal mechanism in the law for such reviews.²⁶

Many of the local officials we interviewed reported that short-term residential and some commercial property tax abatements are granted throughout their municipality. Under state law, a whole town legally can be classified "in need of rehabilitation."²⁷ Because some short-term abatements are available so broadly and given to anyone that satisfies the broad criteria required, revenue may be foregone for projects in non-blighted areas. While the revenue lost on such short-term abatements typically is comparatively small, the fiscal impact is nonetheless a negative one, particularly where the project did not need monetary incentive to proceed.

From a fiscal perspective, the concern is even greater in the case of long-term abatements. Some local officials reported that their municipality's "areas in

need of redevelopment” actually are “pretty well built out.” They explained that some areas that needed redevelopment 10 or 20 years ago are rather developed now, but still are operating under earlier designations leading to additional abatements. Those sentiments have been publicly expressed most frequently concerning Jersey City, whose waterfront has been cited as “a good example of an area where abatements may have been needed to spur development in the late 1970s and 1980s but are likely no longer necessary.”²⁸ Moreover, some local officials we interviewed stated that nearly their entire municipality has been designated “in need of redevelopment,” allowing long-term abatements to occur almost anywhere. On the whole, these interviews revealed that standards concerning these designations seem to be loosely applied and rarely reviewed.

3. Types of Projects

We also looked at the types of projects receiving tax abatements in New Jersey. Some project choices appeared questionable in terms of how they respond to municipal needs or otherwise achieve the underlying purposes of the abatement agreement.

State law permits use of abatements for a wide variety of development types. Municipalities can choose the types of development to promote as well as what specific abatement program to employ. A municipality may be seeking, for example, commercial ratables, a greater residential population, jobs, or upgrades to old buildings. Identified areas of deficiency should drive the focus of abatements to sectors such as large industrial, large commercial retail, small retail, low-income residential, or market-rate residential.

Despite this local discretion, it is far from clear that true local needs are actually driving the types of development ultimately being pursued. For example, many municipalities in northern New Jersey heavily utilize abatements for market-rate housing in order

to attract middle-income and high-income residents. These municipalities, however, like much of the area around New York City, are already densely populated. Instead, redevelopment issues there more typically involve a lack of employment opportunities, low wage jobs, and a lack of affordable housing. Moreover, the ratable base in these areas often is insufficient to support local budgets, as evidenced by state aid levels. Promoting affordable housing and seeking commercial and industrial entities that offer long-term employment and a stable tax base would seem to be more appropriate development choices in these areas. In contrast, continuing to grant abatements for market-rate housing increases population density while straining local budgets that now need to serve more residents who do not fully contribute to normal tax revenues, despite their ability to afford expensive accommodations. Perhaps partially as a result of these abatement practices, many of these neighborhoods recently have faced issues of housing oversupply.

These issues have been raised most prominently in Jersey City, which, for example, granted a developer a second, more generous abatement for a luxury waterfront condominium complex after many units initially failed to sell.²⁹ An Asbury Park tax official reported to us that his municipality has encountered similar problems selling market-rate condominiums constructed with the help of tax abatements.

Municipalities in southern New Jersey face similar struggles in matching abatement practices to community needs. Local officials we interviewed from that part of the state frequently noted their municipality’s emphasis on using abatements to produce enhanced employment opportunities for local residents. In carrying out that effort, many of the abatements awarded in the southern part of the state have been for retail establishments. Retail jobs, however, tend to pay less, be part-time, offer fewer benefits, and develop fewer marketable skills as compared to manufacturing, technology, healthcare

or similar professional jobs.³⁰ Such low-paying retail jobs oftentimes do not relieve many of the public costs associated with low employment, as those who are employed often remain reliant on government services.³¹ While retail establishments create commercial ratables, they often are less stable than industrial or other large commercial entities because the barriers for retail entities to exit the market are usually lower. Further, when large, national-chain retail establishments are lured through use of abatements, the result in some instances is mere displacement of smaller retail establishments and the accompanying jobs and tax base.³² Therefore, while attracting retailers may provide a temporary opportunity to create jobs, those jobs frequently are not sufficient to develop and enhance a sustainable economic base in a community.

An example of this indiscriminate retail emphasis is found in the Township of Gloucester. In a span of six months from mid-2007 to early 2008, the township granted three separate short-term abatements to induce three Wawa stores to expand to become “Super Wawa’s.” Each of these establishments was within two to four miles of the other. In fact, a search on Wawa’s website lists 22 Wawa locations within five miles of the area. The area thus does not seem to lack this type of establishment, bringing into question the need for the tax incentive to induce the business development. When we asked a township tax official about the impetus for the abatements, he noted that all pre-established municipal abatement criteria had been satisfied in these instances and so the township was legally obligated to grant the applications. (That legal issue is explained more fully in the next section of this report). The official further noted his personal view that the abatements were not necessary and that national chains do not need these incentives. Nonetheless, the tax break was granted, in accordance with law.

These types of examples, while anecdotal, indicate that development abatements at least in some

instances are not being chosen based on a reasoned analysis of how best to respond to community needs. In losing this tax revenue, the resources needed to attract sustainable development are diminished and the community may not benefit in the areas of its greatest need.

4. A Perfunctory and Limited Granting Process

These concerns associated with project selection led us to look more squarely at the process being used to determine whether an abatement should be granted. As noted previously, for short-term abatements each municipality adopts a general ordinance that sets forth eligibility criteria, procedures for approval, and any additional requirements imposed by the local governing body. Depending on the procedure set forth in that ordinance, either the municipal tax assessor checks for compliance with all criteria and approves the abatement, or approval of the governing body may also be required. As provided by New Jersey law, applications compliant with the general ordinance “shall” be approved.³³

When we asked local officials about weaknesses we perceived in their local criteria and review processes, they generally cited the lack of more demanding requirements in state statutes as the reason for any deficiencies. This observation, however, fails to recognize the ability that local bodies have through the general ordinance process to set appropriate criteria and procedures that allow for meaningful differentiation of worthwhile and necessary abatements. While compliant applications must be approved, the standards for such compliance can be set high and with great specificity by local governments. Doing so would provide municipalities with more input and control over their abatement programs.

Long-term abatement practice in New Jersey similarly suffers from procedural weaknesses that limit meaningful determinations. The long-term abatement statute is notable in terms of the extent of local discretion provided. Such discretion occurs in the designation of a redevelopment area, the drafting of a redevelopment plan, choosing redevelopers, the crafting of individual financial agreements, and ordinance approval by the local governing body. Requirements built into state law concerning these issues merely represent baseline standards, such as the broad definition of “area in need of redevelopment,” general limitations on abatement length, and parameters for setting PILOTs. Local governments can add to these requirements as long as they do not contradict state mandates.

Perhaps most important in this regard, prudent fiscal planning should steer local governments to undertake a comprehensive cost-benefit analysis to determine whether a particular abatement “investment” is worthwhile. Current law requires municipalities to consider costs and benefits, but does not provide specific instruction regarding the type of analysis to be undertaken or specific issues that are to be considered. As to long-term abatements, state law requires that a “financial agreement approved pursuant to this act shall include . . . the municipality’s determinations as to . . . [t]he relative benefits of the project to the redevelopment of the redevelopment area when compared to the costs, if any, associated with the tax exemption.”³⁴

Local officials we interviewed in many municipalities told us that long-term abatement applications in their town were rarely, if ever, denied, bringing into question the robustness of cost-benefit analyses being undertaken. Many local tax assessors reported not being involved in the process at all, even though they would seem relevant to any review of tax impact. Some municipalities have committees of municipal officials who review abatement applications

and make recommendations to the governing body. Notably absent from these committees, however, are county and school district representatives, another example of the current system’s failure to adequately consider these interests. Even the temporal span of particular long-term abatements seemed to be tied more to how conservative the municipality is towards abatements than to calculated determinations of how long the development needed a subsidy. In short, current requirements and processes could be enhanced to ensure that comprehensive analysis occurs to distinguish worthwhile projects from unnecessary giveaways.

The processes being used also tend to limit meaningful public involvement. Some opportunity for public input occurs during the establishment of redevelopment areas through public notices, hearings, and ordinances. Yet these occur sometimes years before a specific financial agreement is proposed concerning a project with clear enough implications for the public to take notice. In addressing particular projects, the public generally is limited to the ordinance process. This gives them little opportunity to influence outcomes since internal committees make most specific determinations before an ordinance is introduced and, as reported by the local officials we interviewed, these ordinances generally are assured of passage once introduced. As those officials explained, the operative ordinance ultimately is crafted by developers and local officials to ensure that all necessary criteria are satisfied.

In sum, state laws require little outside of perfunctory processes, and municipalities frequently have not added to those standards to ensure that projects are carefully considered and held up to real scrutiny. The law calls for public involvement only through token notice and hearing processes early on at abstract stages, or after specific decisions are already fairly certain, precluding opportunities for meaningful input.

5. Incentives Undermined by Other Rules and Processes

Our review revealed that short-term abatements are frequently applied for and approved after the development itself already has occurred. In fact, state law permits such abatement applications to be made “within 30 days . . . following the completion of the improvement . . . or construction.”³⁵

This practice has the potential to undercut the ultimate purpose of abatements, i.e., to bring about development that otherwise would not occur. If construction is complete before an abatement is sought, it is less likely that the abatement deal spurred the development. In theory, the construction could have been commenced with the hope of later receiving an abatement. However, if the political process is working appropriately (which it may not be, given the conditions previously described), the abatement is not guaranteed until the application is approved. Abatements applied for after the development investment is made risk becoming unnecessary or politically motivated giveaways to projects that were going to occur even in the absence of the tax break.

Our interviews with municipal officials confirmed that granting post-construction short-term abatements is a regular practice in some municipalities. On occasion, the property owner is unaware of the abatement program until the construction is complete and only then learns of the potential tax break and makes the application. Automatic approval of applications even after the project is complete and would have occurred anyway is inconsistent with the intention of creating a development incentive.

Renewals of long-term abatements for existing development, as well as mid-term adjustments to abatement terms to make them more favorable to developers, similarly have the potential to undermine abatement program incentives. Our inquiries

indicated such renewals and adjustments periodically are granted at the request of developers, but are relatively rare. Municipalities justified these renewals and adjustments as preventative measures designed to keep the development from failing or to keep the developer from relocating. While such a threat may be real in some cases, it is important that such claims be closely scrutinized. Companies typically face multiple barriers to leaving a given location, which offers the municipality leverage. Moreover, the municipality should consider whether and to what extent it wants to sustain an enterprise that survives only through continued or enhanced abatements. This requires a thorough evaluation process.

6. Few Clear Follow-up Processes

In addition to lacking meaningful up-front analyses concerning the costs and benefits of awarding a particular abatement, many municipalities fail to periodically monitor abatement performance or determine results once the abatement term is completed. For the most part, municipal officials we interviewed were unaware of any ongoing abatement reviews that held developers accountable to agreed-upon terms or expectations, or that charted progress toward initial goals. Nor were they aware of abatement agreements having been terminated or reopened based on a subsequent assessment by a municipality, other than for technicalities or to extend abatement terms at the request of a developer. Any mid-term or ex post “reviews” that exist typically read more like marketing materials as opposed to economic analyses.

If abatements are to perform as designed, municipalities should implement processes for reviewing whether agreement terms are being met and whether they are producing positive results. These terms and standards should be memorialized in the operative financial agreements and be based upon the benefits that the community expects to

result from the development. Those expected benefits served as justification for the abatement and should be reexamined subsequently to ensure that they come to fruition. If those abatement terms are not being met, more rigorous usage of legal enforcement mechanisms should occur, such as rescission of the abatement terms and reinstatement of tax obligations that would have been owed had no abatement been granted.³⁶

An abatement is an investment that is designed to produce returns. Any responsible investor would want to know if their investment has in fact generated returns, and the public should expect no less in the abatement context. Such periodic and after-the-fact reviews are important for shaping future public choices, i.e., how to maintain and enhance policies that are working and how to reform practices that are not.

Some municipalities are making substantial efforts in this regard. For example, the City of Millville reported doing more than the norm by requiring annual certifications from abatement recipients that address agreement terms. Typically, these certifications include a list of jobs created and any relevant changes to the project itself or to the entity receiving the abatement. More recent abatement agreements in Millville also include provisions that make clear that if a developer fails to fulfill the terms of the abatement agreement, the agreement can be rescinded. Millville in fact reported having rescinded several such agreements.

Thorough reviews of abatement results could be problematic politically for some municipal officials. They could reveal poor decisions in granting the abatement initially or jeopardize agreements that benefit the municipal budget. As a result, to ensure that appropriate reviews take place, it may be necessary to impose legal obligations in this regard on municipal officials.

Best Practices for Municipal Tax Abatements

New Jersey is not alone in dealing with the complexities of property tax abatements. A 2003 report found that 43 states allow municipalities to grant such abatements.³⁷ A review of other states' practices in granting abatements reveals that many states struggle with how best to manage this process. There are, however, identifiable best practices that can help reduce waste, ensure fairness, and support the benefits of tax abatements.

For example, on the issue of the role of school districts in the abatement process, there are protective practices that states have implemented:

- Five states, including nearby Pennsylvania, provide school boards with formal decision-making power over the abatement of school-related portions of property taxes.
- Three states require that school boards be notified and afforded an opportunity to comment when a property tax abatement is being considered.
- Two states require local abatement advisory committees to include school board members.
- Ten states allow school districts to directly negotiate a PILOT with the developer.
- Four states, including New York, provide a portion of collected PILOTs to the affected school district(s).

In some states, property tax abatements are considered and awarded at the county level. This includes states such as Texas, North Carolina, and Florida, all of which have had success in recent decades attracting development. Consideration of abatements at the county level allows for broader

input, coordination, and planning. It might also lead to less municipal competition and muted redistribution of county tax obligations.

Other states have taken steps to improve abatement practices by providing up-front guidance to municipalities. For example, the Vermont Secretary of State has published guidelines concerning local tax abatements that explain relevant laws, principles, and best practices.³⁸ The document specifically explains that “the law only sets up the procedural framework for these decisions; the board for abatement of taxes is responsible for deciding whether taxpayers are worthy of exemption.”³⁹

This statement runs counter to the way many municipalities have interpreted state abatement law in New Jersey. Specifically, many municipalities, as noted previously, view state law as providing all-encompassing criteria that, if satisfied, require the granting of an abatement application. In places like Vermont, publicly and easily available state-issued guidance makes clear that the state law is intended to provide merely a general set of rules to be expanded upon at the local level through imposition of local criteria and exercising of local discretion. If such additional local criteria and discretion are similarly the aim of New Jersey policy-makers, that intention needs to be made clearer, perhaps, as in Vermont, through the issuance of guidance.

Other states have limited the effects of abatements by imposing temporal limitations. For example, in Michigan a variety of tax abatement programs exist, but most appear to be limited to 10 or 12 years in length.⁴⁰ This limited abatement term lessens the long-term impact of the exemption.

As revealed by a 2007 survey, some states have established a layered approval process designed to provide additional checks on abatement decisions.⁴¹ Specifically, six states leave the abatement decision completely to the state government, eight require approval at both the state and local levels, and three

require public referenda in addition to the local government's decision.

Other suggested practices concerning property tax abatements are found in academic studies. Authors who have looked at abatement programs in various locations have recommended the following to improve or supplement current policies:⁴²

- Abatements should be granted only when necessary to attract development that otherwise would not occur.
- Abatements should be strictly limited to areas that are truly in need of rehabilitation or redevelopment.
- Abatements terms should not be any more generous than is necessary to attract the development sought.
- Abatements should be targeted toward the most sustainable, useful development or improvement for an area in order to maximize beneficial outcomes. Emphasis should be placed on infrastructure improvements, creation of quality jobs, revenue to be gained from other sources, and anticipated improvements to the general location.
- All interested stakeholders should be notified of a potential abatement and afforded an opportunity to provide input to ensure all costs are considered and all interests are represented. The more formal this involvement, particularly for those entities that stand to lose revenue, the stronger the impact will be.
- A full cost-benefit analysis should be completed for any potential tax abatement deal to ensure that all issues are considered and that expected outcomes are reasonably assured and worthwhile.
- The agency granting the abatement should:
 - 1) follow-up throughout the abatement period to verify fulfillment of agreement terms; 2) maintain records of abatement agreements for purposes of review and comparison; and 3) ensure full public disclosure of abatement details before, during, and after the term of the agreement. Such details should include the developer name, the project description, the amount of revenue abated and PILOT amount, details of developer compliance with agreement terms, and measurable results and impacts of the abatement.
- Protective abatement terms are necessary from a legal standpoint to ensure accountability and to facilitate recovery of funds in the event promises are not kept.
- Any mechanisms that distort cost-benefit impacts, such as the ability to exempt taxes intended for other entities, should be removed from the abatement process.
- Anti-piracy rules should be established to discourage municipalities from competing for development against each other, which tends to result in a downward spiral of increasingly generous abatement offers.

Many of these well-founded suggestions are not sufficiently part of current New Jersey abatement practices. As noted previously, this is the result of, among other things, nebulous state policies, local constraints or confusion concerning state law, and incentives that push local officials to provide only minimal scrutiny.

Recommendations for Improvement in New Jersey

Based on the research and findings illustrated in this report, there are shortcomings in the way that development-related tax abatements are currently handled in New Jersey. Current processes and policies require significant improvement to create more accountability, consistency, and transparency, and to ensure prudent management of taxpayer dollars.

What follows are a series of recommendations for improving the current system. We recommend that the State Legislature and the Governor amend current law to adopt these recommendations. Even in the absence of new legislation, state and local officials can implement many of these practices under the current legal framework through their own processes and ordinances.

I. The current abatement structure should be adjusted to account for the interests of all affected entities.

- a. *Restructure PILOT agreements.* The current legal structure allows municipalities to keep almost the entire PILOT amount in the case of long-term abatements. This creates a perverse incentive whereby the municipality may gain revenue through granting an abatement, while other government entities lose out. This imbalance should be eliminated. There are several means through which this could be accomplished. The law could be changed to provide that PILOT collections are to be split along the same distribution lines and percentages as normal tax collections. Alternatively, PILOTs could be eliminated entirely, in favor of partial tax reductions. Another option is simply to permit municipalities to exempt only their portion of tax revenue owed, with abatements of other portions potentially granted at the discretion of the other receiving entities, such as counties and schools.
- b. *Expand the role of county governments.* County governments should coordinate redevelopment and abatement practices across municipalities. This should include county review of large development projects that may receive abatements and would impact tax burdens on county residents. The process should be designed in a way that discourages simultaneous negotiation and poaching of development among municipalities in the county, thereby preventing a race to the bottom. A more prominent county role would better manage tax impacts, help monitor development, and ensure that such development fits with broader interests as well as more parochial ones.
- c. *Include other affected stakeholders more directly and earlier in the process.* Like county governments, school districts and the tax-paying public are interested parties in the abatement process. Yet, current abatement practices generally are not designed to ensure that these voices are fully heard. Municipal tax abatement committees that review and recommend the awarding of tax abatements should include school district representation, perhaps on a non-voting basis. Municipalities may find it helpful to include county officials on these committees as well, as a means to further the coordination process described above. School and county officials should be

similarly involved at earlier stages of the redevelopment process, such as when redevelopment areas and plans are being established, and when general ordinances are being considered that will set forth local abatement requirements. At a minimum, these entities should receive direct notice of these types of impending actions and be granted a meaningful opportunity to be heard.

Public officials should similarly take steps to foster more general public discussion on these issues and provide specific justification to taxpayers as to why taxes are being abated in particular circumstances. While municipalities' typical ordinance review process provides a modicum of public notice, a more thorough and fulsome public discussion of abatement practice, including the designation of areas of redevelopment and abatement criteria, would be appropriate in view of the extent to which the abatement tool is being used in some locations. One possibility is to hold a "community meeting" at an early stage in the redevelopment process, which would focus on "desired outcomes."⁴³ Use of a public referendum on large projects also should be considered.

II. Abatements should be granted only when it is in the public interest to do so.

- a. *Conduct robust cost-benefit analyses.* In seeking to fulfill applicable statutory requirements, municipalities should carry out comprehensive and detailed cost-benefit analyses for potential long-term abatement projects. The analysis should include consideration of any losses in

ratable property that would be suffered by the municipality, the county, and the local school district, as well as the resulting revenue implications. It should also consider the necessity of the abatement for attracting the project, justification concerning the length of the abatement period, the likelihood of community benefits in both the short and long terms, and how those potential benefits tie into community needs. The completed analysis should be revisited if adjustments to agreement terms are subsequently proposed. The cost-benefit analysis for a particular abatement should be made publicly available and should be forwarded to a designated state agency, such as the Local Finance Board, to ensure that the analysis conducted was complete and fair.

- b. *Strengthen criteria and processes for general ordinances and related documents.* Stronger criteria and processes should be set forth in local ordinances up front to ensure that abatement applications adhere to appropriate standards to receive approval. Municipalities should consider, in view of local community needs, what attributes a project must have to make it worthy of relieving the developer of obligations that other taxpayers must fulfill. Local officials should then ensure that those requirements are memorialized in the general ordinance and that applications are recommended for approval only when those requirements have been satisfied. These criteria should be designed in a way that ensures that abatements are granted only in locally pre-defined circumstances, only when consistent with the public interest, and only when necessary to spur the development or improvement.

Abatement agreements also should include appropriate enforcement provisions, permitting rescission of the agreement, imposition of penalties, or other remedial measures for situations where the developer fails to fulfill its obligations.

- c. *Periodically review designations of areas "in need of redevelopment."* Redevelopment classifications should be reviewed on a periodic basis to determine whether previously identified blighted conditions continue to exist. These reviews should be designed to ensure that new abatements are not granted after an area previously in need of redevelopment has already met predetermined improvement goals. In such circumstances, substantial tax incentives should no longer be necessary to attract development. These periodic reviews would avoid unnecessary exclusion from otherwise applicable tax obligations, while also serving broader goals of monitoring and assessing redevelopment progress.
- d. *Require abatement applications earlier.* Absent exceptional circumstances, applications for short-term abatements should be required to be submitted before project construction begins. Requiring pre-construction applications would decrease the chances of abatements being granted to developers that do not require the financial assistance and are not motivated by it. Local officials also could gain more input into project planning if applications were made on a pre-construction timeframe.

III. Local public officials must take steps to ensure appropriate transparency and follow-up review of abatement agreements.

- a. *Enhance local tax listings.* Local tax listings should clearly identify rehabilitation and redevelopment abatements. Coding these items clearly and consistently on public tax listings will promote transparency and facilitate more refined analyses of abatement practices and policies.
- b. *Review developer performance.* Municipal officials should periodically review developers' performance under abatement agreements. These reviews should specifically include determinations of whether the developer is meeting agreed-upon abatement terms and performance standards that are based upon the benefits expected to result from the award of the abatement. If the developer has failed to satisfy agreed-upon terms, the enforcement provisions in the abatement agreement should be utilized.

These performance evaluations could be made publicly available, including in on-line form. Performance evaluations for individual abatements can be used to undertake overall programmatic reviews that ascertain whether benefits have been attained, at what cost, and how outcomes match up to expectations. This analysis can be used to guide future decisions and strategies.

IV. The state should play a more active role in the abatement process.

- a. *Increase guidance on granting and implementing tax abatements.* The state,

through the Department of Community Affairs, should offer detailed and readily available guidance to municipalities on interpreting and implementing the state's tax abatement laws. Recommendations should be developed and published concerning best practices in local processes and criteria. This is important, for example, in setting standards for measuring performance and in designing abatement agreements most likely to be protective of the public interest.

- b. *Compile appropriate records.* There are a range of miscellaneous abatement-related records that current law requires municipalities to submit to DCA, but the information received has not been analyzed, monitored, or catalogued. State officials should ensure that they are obtaining detailed information from municipalities concerning their abatement policies and practices. That information should be organized into on-line, searchable databases that include property information, project developer and related project information, relevant dates, local reports on abated tax revenue, and information concerning costs and benefits. This information, which should be compiled and published at least annually, will reflect the financial implications of the abatement choices being made. The collection of this data is analogous to new state laws requiring the state to account for "expenditures" of state money that occur through tax credits and similar incentive programs.⁴⁴ Reports of these local government "tax expenditures" are similarly appropriate.

The resulting central repository of information could be used for establishing patterns of implementation, identifying

red flags in practices, and determining the circumstances under which abatements have proven to be worthwhile. Perhaps most importantly, taxpayers would be able to assess local and more general abatement practices. If desired, state policy-makers also could use the compiled data in determining state aid calculations or to inform needed changes in guidance or monitoring. On the state aid issue specifically, the state may opt to consider localities' abating of substantial tax revenues in determining the extent to which either formula-based or extraordinary state assistance is appropriate.

- c. *Increase monitoring of tax abatement practices.* The state also should actively review municipal abatement practices and choices, particularly with regard to high-value abatement agreements. This function could be handled, for example, by the Local Finance Board in DCA, which currently reviews and approves various other financial practices of local government units. This review would help detect violations of predetermined standards and would subject agreements to an additional level of scrutiny concerning the appropriateness of the development and the municipality's diligence in safeguarding the interests of taxpayers.

Conclusion

Any abatement program should be crafted carefully and should be designed to minimize the negative effects of resulting tax inequities. Tax abatements offer relief only to a selected subset of taxpayers, using the political process to shift tax burdens. Because these tax exemptions break from equitable tax principles, they should be exercised sparingly and only if they offer a considered and tailored solution.

Tax abatements are oftentimes costly and controversial, and many of the keys to using them successfully are difficult to implement. Thus, government entities should consider not only what are the most prudent and responsible abatement measures, but also whether other community development alternatives are available and potentially more appropriate. These alternatives include enhancing local infrastructure and services, investing in transportation, creating training and education programs to improve the local workforce, undertaking local beautification projects, and providing assistance to developers with land acquisition or obtaining financing. All of these types of investments could make an area more attractive while creating lasting value.

Like many states, New Jersey has struggled in applying the abatement tool. This report has identified a number of current abatement practices that jeopardize the benefits of abatements and put taxpayers at risk. The report recommends specific reforms in this regard. These reforms would improve the current system and bring about accountability that does not currently exist. They would make poor decisions harder to justify and more transparent to stakeholders, address perverse incentives that distort decision-making, and add greater consistency and professionalism to the process. Perhaps most importantly, they would result in greater information gathering that would

facilitate additional targeted reforms and improvements in the future.

Endnotes

¹ N.J. Const., art. VIII, § 1, par. 6; N.J. Const., art. VIII, § 3, par. 1.

² N.J.S.A. 40A:20-12b(2)(e).

³ N.J.S.A. 40A:20-2.

⁴ Township of Winslow, “5 Year Abatement-Exemption Program,” <http://www.winslowtownship.com/content/133/787.aspx>.

⁵ City of Jersey City, “Tax Abatements in Jersey City” (2009), www.cityofjerseycity.com/uploadedFiles/City_Government/Department_of_Business_Administration/Copy%20of%20abatements%20report.pdf.

⁶ See, e.g., *United States v. Matthew Scannapieco*, No. 05-267 (D.N.J. April 12, 2005) (former Mayor of Marlboro); *United States v. Kenneth Saunders*, No. 03-236 (D.N.J. March 31, 2003) (former Mayor of Asbury Park); *United States v. Peter Cammarano*, No. 10-275 (D.N.J. July 21, 2009) (former Mayor of Hoboken).

⁷ See, e.g., Mane Howland, “Property Taxes and the Birth and Intra-regional Location of New Firms,” *Journal of Planning Education and Research*, Vol. 4, No. 3, 148-56 (1985), jpe.sagepub.com/cgi/content/abstract/4/3/148; Dafna Schwartz et al., “The Ineffectiveness of Location Incentive Programs,” *Economic Development Quarterly*, Vol. 22, No. 2, 167-79 (2008), edq.sagepub.com/cgi/content/abstract/22/2/167; Robert G. Lynch, “Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development,” Economic Policy Institute, at vii, viii, ix, 21-23, 34-36, 47 (2004), epi.3cdn.net/f82246f98a3e3421fd_o4m6iiklp.pdf. But see George W. Morse and Michael C. Farmer, “Location and Investment Effects of a Tax Abatement Program,” *National Tax Journal* (1986), Vol. 39, No. 2, at 229 (finding some positive outcomes for abatements, but only if extra aid offsets school losses).

⁸ See, e.g., Edward Van Embden, “Cumberland County Officials Debate Merits of Tax Abatements,” *Press of Atlantic City*, 9 Feb. 2009.

⁹ Luke Middleton, “Literature Review: Tax Abatements and Economic Development Incentives,” Center for Economic and Business Analysis, University of Kansas (Jan. 2001), at 8, www.ipsr.ku.edu/resrep/pdf/r49.pdf.

¹⁰ *Town of Secaucus v. City of Jersey City*, 19 N.J. Tax 10, 28 (2000).

¹¹ N.J.S.A. 40A:20-12a.

¹² N.J.S.A. 40A:12A-6b(5).

¹³ N.J.S.A. 40A:20-12; N.J.S.A. 40A:20-9d; N.J.S.A. 40A:21-11d; N.J.S.A. 40A:21-21.

¹⁴ N.J.A.C. 5:30-8.8.

¹⁵ See Department of Community Affairs, Division of Local Government Services, Property Tax Information (April 2010), www.nj.gov/dca/lgs/taxes/taxmenu.shtml.

¹⁶ See www.njactb.org.

¹⁷ Based on data collected from the 2000 U.S. Census and the 2006-2008 American Community Survey by the U.S. Census Bureau.

¹⁸ Donald Kruckeberg, “Free New Jersey: The Burden of Property Tax Exemptions,” *New Jersey Policy Perspective* (Dec. 2004).

¹⁹ Department of Community Affairs, Division of Local Government Services, Special Municipal Aid Program Audits (April 2010), www.nj.gov/dca/lgs/research/special_audit/special_audit.shtml.

²⁰ New Jersey by the Numbers, Property Taxes, www.nj.com/news/bythenumbers/.

²¹ See Charles Hack, “Power Plant Gets Its Abatement; Deal Will Bring Bayonne \$100M,” *Jersey Journal*, 12 Nov. 2009; Charles Hack, “Generating Plant Builders Seek Bayonne Abatement,” *Jersey Journal*, 9 Oct. 2009.

²² See, e.g., Edward Van Embden, “Cumberland County Officials Debate Merits of Tax Abatements,” *Press of Atlantic City*, 9 Feb. 2009; Naomi Bressler & Carolyn Topp, “All that Glitters Isn’t Gold: Property Tax Abatements in Jersey City,” *New Jersey Policy Perspective*, at 7.

²³ N.J.S.A. 40A:12A-5(e); N.J.S.A. 40A:12A-14(a); see *Gallenthin Realty Dev., Inc. v. Borough of Paulsboro*, 191 N.J. 344, 373 (2007) (describing operative redevelopment standard as whether area in question “has become stagnant and unproductive”).

²⁴ Bressler and Topp, *supra*, at 6.

²⁵ See, e.g., Department of the Public Advocate, *Reforming the Use of Eminent Domain for Private Redevelopment in New Jersey*, at 18-19 (May 2006) (recommending, in eminent domain context, time limit on number of years area can be designated as blighted before original designation process must be renewed).

²⁶ See, e.g., Hon. James R. Zazzali & Jonathan L. Marshfield, *Providing Meaningful Judicial Review of Municipal Redevelopment Designations: Redevelopment in New Jersey Before and After Gallenthin Realty Development, Inc. v. Borough of Paulsboro*, 40 Rutgers L.J. 451, 499 (2009); *Dutch Neck Land Co. v. City of Newark*, No. A-5825-06T2, 2008 N.J. Super. LEXIS 347, at *37-38 (App. Div. May 14, 2008); see also Department of the Public Advocate, *Reforming the Use of Eminent Domain for Private Redevelopment in New Jersey*, at 18 (May 2006) (“[W]ithout time limits or more specificity in the [redevelopment] plans, the potential for redevelopment and eminent domain can hang over the heads of homeowners and businesses for years, discouraging investment and undermining their ability to sell their properties.”).

²⁷ N.J.S.A. 40A:21-3(b).

²⁸ Bressler & Topp, *supra*, at 3.

²⁹ Amy S. Clark, “Council to Vote on Developer’s Request to Reduce Payments,” *Jersey Journal*, 17 June 2009; Antoinette Martin, “GOOD RESPONSE 25% of Condos at Crystal Point in Downtown Jersey City Are Sold,” *New York Times*, 26 June 2009, www.jclist.com/modules/newbb/viewtopic.php?topic_id=17870.

³⁰ New Rules Project, “Key Studies on Wal-Mart and Big Box Retail,” Institute for Local Self-Reliance, www.newrules.org/retail/key-studies-walmart-and-bigbox-retail; Kate Davis et al., “Subsidizing the Low Road: Economic Development in Baltimore,” *Good Jobs First* (Sept. 2002), www.goodjobsfirst.org/pdf/balt.pdf.

³¹ “Everyday Low Wages: The Hidden Price We All Pay for Wal-Mart,” Democratic Staff of the House Committee on Education and the Workforce (Feb. 2004); “Hidden Cost of Wal-Mart Jobs,” University of California-Berkeley’s Institute for Industrial Relations (Aug. 2004).

³² Stacy Mitchell, “Major Flaws Uncovered in Study Claiming Wal-Mart Has Not Harmed Small Businesses,” Institute for Local Self-Reliance (Dec. 2008); Dr. Kenneth Stone, “Competing with the Discount Mass Merchandisers,” *Economic Development Review* (Spring 1995).

³³ N.J.S.A. 40A:21-16.

³⁴ N.J.S.A. 40A:20-11.

³⁵ N.J.S.A. 40A:21-16.

³⁶ See N.J.S.A. 40A:21-12.

³⁷ National Education Association, *Protecting Public Education from Tax Giveaways to Corporations* (Jan. 2003), www.goodjobsfirst.org/pdf/edu.pdf.

³⁸ Vermont Secretary of State, *About Abatement* (April 2007), www.sec.state.vt.us/municipal/handbooks.htm.

³⁹ *Id.* at 8.

⁴⁰ Citizens Research Council, *Survey of Economic Development Programs in Michigan* (June 2007), www.crcmich.org/PUBLICAT/2000s/2007/rpt347.pdf.

⁴¹ Robert W. Wassmer, *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-Sub-National Economic Activity in the United States* (Dec. 2007), at 14-15, www.csus.edu/indiv/w/wasmerr/increasingpropertyabatement.pdf.

⁴² See Luke Middleton, *Literature Review: Tax Abatements and Economic Development Incentives*, Center for Economic and Business Analysis, University of Kansas, www.ipsr.ku.edu/resrep/pdf/r49.pdf; Sands et al., *Implementing Tax Abatements in Michigan: A Study of Best Practices*, *Economic Development Quarterly* (2006), www.michigansuburbsalliance.org/downloads/TaxAbatements.pdf; Good Jobs First, “Reform #4: Protect Education from Tax Giveaways” (April 2009), www.goodjobsfirst.org/accountable_development/reform4.cfm; Robert W. Wassmer, *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-Sub-National Economic Activity in the United States* (Dec. 2007), www.csus.edu/indiv/w/wasmerr/increasingpropertyabatement.pdf; Laura A. Reese and Gary Sands, “The Equity Impacts of Municipal Tax Incentives: Leveling or Tilting the Playing Field?,” *Review of Policy Research* 23(1), at 71-94 (2006).

⁴³ Department of the Public Advocate, *Reforming the Use of Eminent Domain for Private Redevelopment in New Jersey*, at 17 (May 2006).

⁴⁴ N.J.S.A. 52:27B-20a.