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'Stranded Assets' Bill May Change Playing Field for Local Redevelopment, but Will It Work?

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Over the last several years, many retailers have closed their doors, leaving empty spaces in retail centers and shopping malls across the state. With the increased presence of online shopping and new trends in retail real estate development, some claim there is little hope for the revitalization of these centers. The same has been said for suburban office parks that have suffered from an increasing number of untenanted spaces and "dark buildings." The change in suburban office parks has been caused by shifting demographics, as employers are downsizing due to technology, allowing more employees to work from home, and moving back to urban areas where the next generation of workers eschews the suburban model pursued by their parents.

The darkened building shells and expansive empty parking lots of these retail and office developments are seen by municipal officials as relics of the past that impose a financial burden on their communicates. Owners of such properties often successfully appeal the tax assessment due to reduced income streams resulting from the vacancies, thereby shrinking the tax ratable base and causing increases in the tax rate and tax burden for all taxpayers. There is also a concern that the presence of such properties has a depreciating effect on surrounding property values.

To address this problem, New Jersey has now expanded the criteria for a designation under the Local Redevelopment and Housing Law, N.J.S.A. 40A:12A-1 et seq. (LRHL), to include "stranded assets." Specifically, the statute establishes a new criterion to designate property as being "in need of redevelopment" or "blighted": any "building or buildings previously used for commercial, retail, shopping malls or plazas, office parks" that had "significant vacancies … for at least two years." N.J.S.A. 40A:12A-5b.

The designation of a property as in need of redevelopment is significant because it affords a municipality the power to offer private sector partners incentives, such as long-term tax exemptions and abatements, and zoning changes to redevelop the properties within the designated area. Furthermore, such a designation may empower the municipality to acquire such properties by eminent domain.

The stranded asset law is a well-intended effort to address a very real problem, but it is hardly a panacea and is very likely to spawn a new round of redevelopment challenges, like those waged in the middle part of the last decade.

Municipalities should be wary of using the new stranded asset criteria under the LRHL for redevelopment projects, especially where the power of eminent domain is authorized and will result in possible takings of these properties from their current owners so that they may be redeveloped by other private parties chosen by the town. The owners of larger office complexes and shopping malls are typically sophisticated real estate investors and developers and will be aware of the threat imposed by a blight designation, most significantly, the possibility of losing the property by eminent domain to another developer. And while the municipality may proceed under the "non-condemnation" area designation—thus, eliminating the eminent domain threat—the property owner is still confronted with a significant risk of ceding control of its property over to the municipality. That control goes beyond the usual police powers of zoning and code enforcement and extends to who has the right to redevelop the property, as a "properly" designated redevelopment project can permit the municipality to designate the redeveloper for the site, and it need not choose the current owner.

The last amendment to the LRHL was embodied in in P.L. 2014, C. 159. This amendment: (a) codified certain protections for property owners in *Gallenthin Realty Development v. Borough of Paulsboro,* 191 N.J. 344 (2007), and *Harrison Redevelopment Agency v. DeRose*, 398 N.J. Super. 361 (App. Div. 2008), both of which resulted in judicial scrutiny of the use of eminent domain in local redevelopment projects; and (b) provided municipalities with the option of having local redevelopment projects with, or without, the power of eminent domain.

As has always been the case with blight designations, a property owner has much to lose and, as such, has incentive to fight the designation to protect and preserve its property rights. And while a designation under the new law may preliminarily seem to present a criterion based on fact as opposed to the other criteria (which are driven by the subjective opinion of a professional planner), upon closer review the conditions that may satisfy this new criterion may not be so clear at all.

One glaring issue with the new law is that it does not define "significant vacancies." As drafted initially, the bill (A-1700) addressed buildings that were vacant or "partially vacant with less than 50% occupancy." The bill was amended on the Senate Floor to replace the "50 percent or more vacancy requirement with a significant vacancy requirement," and also to extend the "significant vacancy" criterion to all types of commercial, manufacturing and industrial properties, not just retail and office properties. While the duration of the vacancy is set forth in the statute, the extent of such vacancy, as of now, is left to the discretion of municipal officials. Some may consider 25% as a "significant vacancy." Consider these examples:

- 25% of a small retail center containing 12,000 square feet (sf) of leasable area, means that 3,000 sf could be considered a "significant" vacancy under the new law. But should that condition alone be enough to render property blighted and subject to acquisition by eminent domain? What if the vacancy is caused by an offsite condition, such as an ongoing road improvement project? Or what if the vacancy is intentionally allowed to remain in place by the landlord, who himself or herself intends to redevelop the entire shopping center to attract new tenants?
- What about a 200,000-sf office building, with 50,000 sf vacant, that may appear to constitute a "significant" vacancy? Is the owner entitled to allow space to remain vacant up to a certain point before reinvesting in its property to upgrade and attract new tenants? A process that may very well take more than the two years provided under the new law.

It does not appear that the stranded asset amendment accounts for such considerations.

Another ambiguity is what constitutes "vacant" space? The common understanding —that the space is empty—may not always be that black and white. For example, there exist single-tenanted properties where the tenant no longer occupies most or any part of the building but continues to pay the rent for a period of more than two years. In that case, where the landlord maintains the property and stays current on the taxes, is the space considered "vacant" under the new law? Or consider a landlord of a retail space who is attempting to repurpose vacant space for new uses, such as a restaurant, physical fitness or entertainment center. Such projects take time to find the right tenant, obtain necessary approvals and permits, secure necessary financing, and fit out the space. In some instances, the space may be vacant, i.e., empty, for more than two years, during which time the owner is making diligent efforts to repurpose the space. However, the local mayor may have other ideas for the space during that time, and the owner may face a possible seizure of that property as an area in need of redevelopment under the stranded asset designation.

Perhaps most troubling is the new law's disregard for the purpose of the LRHL—a law which, pursuant to N.J.S.A. 40A:12A-2, is supposed to be used only where private enterprise is unable to correct or ameliorate conditions of deterioration and improper, or lack of proper, development. In other words, the LRHL is a tool to combat blight. The new law equates vacancy, at an undefined level, of buildings of all sizes, with blight. Moreover, it does not give any consideration for the circumstances of the vacancy or cause thereof. Nor does it provide for consideration whether such condition has caused or contributed to blight in the area.

Proponents of the new law will cite to the need for this power to confront a growing problem. Property owners must trust that municipal officials will exercise sound discretion in pursuing a stranded asset designation. But, as has often been the case with other provisions of the LRHL, it will likely be left to the courts to serve as an important check on the use of this new tool, to protect against the potential abuse of the LRHL powers as recognized by our Supreme Court. *See 62-64 Main Street LLC v. Mayor and Council of City of Hackensack*, 221 N.J. 129, 171 (2015).

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