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CHRISTINE TODD WHITMAN, *GOVERNOR*
JANE M. KENNY, *COMMISSIONER*
BETH GATES, *DIRECTOR*

DEVELOPER ESCROW ACCOUNTING: RESPONSE TO QUESTIONS AND COMMENTS

The Division of Local Government Services has received many questions and comments concerning changes in the Developer Escrow Law, (see P.L. 1995, c. 54, and Local Finance Notice CFO-95-7). The Division also solicited comments from the various professional groups affected by the legislation, including engineers, planners, municipal attorneys, and government finance officers.

The questions and comments received by the Division covered several different aspects of the legislation. Resolution and responses to the matters involve integrating the escrow law with the Local Budget Law (N.J.S.A. 40A:4), the Local Fiscal Affairs Law (N.J.S.A. 40A:3), the Local Public Contracts Law (N.J.S.A.40A:11), and older sections of the Municipal Land Use Law (N.J.S.A. 40:55D).

To assist in assessing some of the issues raised, the Division established an Advisory Committee. The Committee's mission was to consider the questions and comments received, and to agree on guidelines that municipalities could follow in resolving Developer Escrow matters. Although there was broad agreement by the Committee on many issues, **municipalities are strongly encouraged to resolve their own particular problems in a way that works best for them and conforms with the intent of the law.**

Most important, decisions or opinions about matters relating to the Escrow Statute, should be based on **reasonableness**. In the event that disputes arise due to challenges over what might be considered reasonable, the appeal process should be pursued as an instrument for settling such disputes. Issues concerning reimbursement of certain expenses incurred by contracted professionals can be addressed directly in the Professional Service Contract.

A summary of the comments given by the Advisory Committee to some of the key issues raised on the Developer Escrow Law is provided in the following pages of this report.

Beth Gates, Director
Division of Local Government Services

Distribution: Municipal Chief Financial Officers

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101 South Broad Street CN 803 Trenton, New Jersey 08625-0803

I. BILLABLE COSTS

A) **ISSUE: What is a municipal professional?**

COMMENT: A **professional** is generally construed to include professional planners, attorneys and engineers **directly employed** by a municipal government (i.e., those on the municipal payroll), and who have direct operative involvement in the review and inspection functions.

As an alternative to using municipal professionals, the law permits use of outside consultants (i.e., **contracted professionals**) in instances where the municipality either has no resident professional staff, or if the application being reviewed is of a nature that is beyond the scope of expertise of the regular 'in-house' staff. This is in keeping with N.J.S.A. 40:55D-53.2(a)(3) of the Developer Escrow Law.

B) **ISSUE: The law is silent on the question of what constitutes out-of-pocket expenses and overhead costs.**

COMMENT: In the absence of a statutory definition, this issue should be agreed upon by the municipality and the contracted professional and should be considered on the basis of **reasonableness**.

C) **ISSUE: How can municipalities bill for services provided by Planning or Zoning Board administrators?**

COMMENT: Pursuant to N.J.S.A. 40:55D-53.2 (a)(5), costs for municipal administrative functions are not billable to escrow. The cost for services provided by planning and zoning board administrators **should be covered by the fixed administrative (application) fees**. Such fees should be reasonable and established by ordinance.

D) **ISSUE: How can municipalities bill for services provided by municipal clerical staff working in conjunction with municipal professionals?**

COMMENT: These costs may be **factored into the hourly billing rate of municipal professionals**. N.J.S.A. 40:55D-53.2(a)(6) allows the municipal professional's hourly base salary to be increased by an amount not to exceed two times the person's hourly rate. This increase is for purposes of covering staff support and related overhead expenses incurred by the municipality in connection with its review of development applications or inspection of improvements.

E) **ISSUE: How can contracted professionals bill for services provided by their clerical staffs?**

COMMENT: **This depends on the nature of the professional service contract that the contracted professional has with the municipality**. In general, State law permits at least two ways of billing for clerical support. One way is to include the cost of the clerical staff directly in the professional's hourly billing rate. Another way is for the professional to establish a billing rate for every class of professional and clerical employee that the professional uses to provide services, and include them in the professional services contract with the municipality.

In either case, it is important to bear in mind that, pursuant to N.J.S.A. 40:55D-53.2(a)(6), the billing rates and procedures established in the contract for development review and inspection work charged to escrow accounts must be the same as for "other work of the same nature by the professional for the municipality when fees are not reimbursed or otherwise imposed on applicants or developers".

F) **ISSUE: Can fee schedules be established in lieu of hourly billings?**

COMMENT: The Developer Escrow Law does not specifically address this issue. N.J.S.A. 40:55D-53.2(b)(4 and 5) states that municipalities must establish the amount of the initial escrow deposit in accordance with variables concerning the number of lots in a subdivision (for subdivision review), or the area of the site to be developed (for site plan review). Nothing prohibits a practice of billing for review and inspection services on a fixed fee basis, pursuant to similar variables. Thus, the use of a fee schedule (for subdivision review work), or fixed charges (for reviewing site plan applications), or the use of some other model appears to be a reasonable alternative to billing on the basis of an hourly fee.

Regardless of how a municipality opts to bill for escrow related work, however, it is important that costs are kept reasonable and that the applicant is fully informed of the charges assessed for application reviews and inspections.

G) **ISSUE: Travel Costs**

COMMENT: Within the context of N.J.S.A. 40:55D-53.2(a)(4), travel costs associated with site plan review and site inspections **are considered as reimbursable out-of-pocket expenses**. Municipalities should monitor such costs, however, to ensure that travel-related expenses are not abused.

In the event that a scheduled site visit is unexpectedly canceled due to inclement weather, conflicts in schedule or other such circumstances, the cancellation should not normally justify reimbursement. Again, however, the test of **reasonableness** should prevail.

In instances where site visits/inspections are conducted on the same day for multiple clients, travel costs incurred should be reasonably split among the various clients served.

In instances where experts must be brought in from another State/Region in order to testify on an application, costs incurred in connection with said experts travel and lodging might be considered as reimbursable - **provided**, however, that the need for expert opinion is justified, that the costs are reasonable, that the applicant is advised ahead of time, and that the practice of bringing in outside experts is not abused.

H) **ISSUE: Meeting room rentals**

COMMENT: N.J.S.A. 40:55D-53.2(a)(5) prohibits meeting room charges as a billable escrow cost. Depending on the size of the applicant's project, and the anticipated public turnout and response, in the event that municipal facilities are inadequate and outside space is therefore needed, the municipality and applicant should work jointly to determine the specifics of need, cost, etc. - and who will be responsible for defraying the extras.

I) **ISSUE: Special Meetings**

COMMENT: Although not specifically addressed in the law, it seems reasonable to conclude that if special meetings are required during the review of an application, the **time allotted by professionals for attending such meetings should be considered part of the review process and therefore, chargeable to escrow**. Ancillary costs incurred as a result of the special meeting may or may not be chargeable, depending on the nature of the cost. For example, pursuant to N.J.S.A. 40:55D-53.2(a)(4), travel time to and from the meeting might be charged to the escrow account as an out-of-pocket expense. On the other hand, based on N.J.S.A. 40:55D-53.2(a)(6), overhead expenses (utility costs, custodial fees, etc.) are not directly chargeable.

J) **ISSUE: Certified Stenographers**

COMMENT: **The law does not address the issue of whether the cost of retaining certified stenographers is chargeable to escrow**. Therefore, municipalities should use their own discretion in deciding how to handle such charges. In certain instances, charging the escrow account might be justifiable - i.e., if the stenographer is called in to transcribe the minutes of a special meeting convened at the request of the applicant. Under ordinary circumstances, however, when the stenographer is recording the minutes of a Planning Board meeting and the applicant's project is one of several items on the agenda, the municipality should be prepared to absorb the cost as part of its overhead. Municipalities are encouraged to apply reasonableness in deliberating this matter.

II. BILLING PRACTICES

A) **ISSUE: Information reported on vouchers**

COMMENT: As per N.J.S.A. 40:55D-53.2(c)(1), information reported on vouchers must be **specific in terms of describing services provided**. Use of 'catch-all' phrases, such as 'project coordination' or 'application coordination' are inappropriate.

B) **ISSUE: Vouchers sent to applicants**

COMMENT: Pursuant to N.J.S.A. 40:55D-53.2(c)(4), professionals are required to send copies of all vouchers and statements submitted to the Chief Financial Officer of the municipality simultaneously to the applicant. Vouchers sent to applicants by professionals should state that they are being sent **for information purposes only**. Otherwise, such statements might be construed as bills with payment due.

Municipalities should **not** be sending applicants a copy of any vouchers received from contracted professionals. As specified in N.J.S.A. 40:55D-53.2(c)(4), the Chief Financial Officer's obligation is to issue monthly and/or quarterly statements to the applicant summarizing all transactions, including escrow fund deposits, interest earnings, disbursements and account balances.

Municipalities are required to issue quarterly reports, even if there is no activity on the account.

III. FEES AND CHARGES

A) **ISSUE: How are escrow accounts established?**

COMMENT: Pursuant to N.J.S.A 40:55D-53.2(b)(3), **the initial amount of the escrow deposit is established by Ordinance**.

Pursuant to N.J.S.A. 40:55D-53.2(b)(4), **for subdivision applications**, the amount of the deposit shall be based on the number of lots.

Pursuant to N.J.S.A. 40:55D-53.2(b)(5), **for site plan applications,** the amount of the deposit shall be based on....a) the area of the site to be developed, or....b) the square footage of buildings to be constructed, or....c) an additional factor for circulation-intensive sites, such as those containing drive-through facilities.

Deposits for inspection fees shall be in an amount not to exceed (except in extraordinary circumstances) the greater of $500 or 5% of the cost of improvements. Pursuant to N.J.S.A. 40:55D-53(h), fees of less than $10,000 may be paid in two installments. Inspection fees which are anticipated to exceed $10,000 may be paid in four installments.

B) **ISSUE: In addition to review fees, can municipalities still charge filing fees?**

COMMENT: **Yes**. Filing fees may still be charged to the applicant by the municipality - e.g., $100 for Minor Subdivision; $300 for Preliminary Site Plan, etc.

IV. GENERAL ACCOUNTING

A) **ISSUE: Can new costs (e.g. computer software, extra staff) incurred as a result of escrow law changes be appropriated outside of the budget cap?**

COMMENT: Yes.

B) **ISSUE: Reporting escrow account interest**

COMMENT: Interest earned on an escrow account should be put on an **IRS 1099** form in the applicant's name. Pursuant to N.J.S.A. 40:55D-53.1, the municipality is not required to refund any interest which is less than $100 per year. If the amount of interest exceeds $100, the entire amount is due to the developer - except that the municipality may retain up to 1/3 of the interest to cover administrative expenses.

C) **ISSUE: When escrow account funds are depleted, how much should be replenished by the applicant?**

COMMENT: When replenishing escrow accounts due to insufficient funds, **the amount should be based on the remaining work**. Pursuant to N.J.S.A. 40:55D-53.2(c)(7), the amount of the supplemental deposit also must be agreed upon by the municipality and the applicant. Any funds remaining after project close-out are returned to the applicant.

Pursuant to N.J.S.A. 40:55D-53.2(c)(7), if an account has a negative balance and, after a reasonable time period, the applicant refuses to restore funds, all reviews and work on the project can be stopped - except for any required health and safety work.

D) **ISSUE: Change of applicant or new developer takes over project**

COMMENT: Although not specifically addressed in the law, it would be advantageous for a municipality to require an **applicant to notify the municipality** when a project is taken over by another party, as the change could create problems concerning ownership of the escrow funds, reporting requirements, etc. Such notice might be included as part of the municipality's development regulations, or other information provided to applicants and developers.

V. CLOSING OUT THE ESCROW ACCOUNT

A) **ISSUE: How does the municipality close out an account?**

COMMENT: Payout of any remaining balances after all improvements are completed **must be authorized by resolution of the governing body**, essentially following the same procedures as the bill-paying process.

B) **ISSUE: What about costs incurred after project close-out?**

COMMENT: Costs incurred after project close-out generally include inspection work and additional legal fees. N.J.S.A. 40:55D-53(h) establishes requirements that deal with escrow deposits for **inspecting improvements** including streets, grading, pavements, gutters, curbs, street lighting, shade trees, water mains, storm and sanitary sewers, etc. **The law explicitly states that municipalities may require deposits for inspection fees in an amount not to exceed the greater of $500 or 5% of the cost of improvements. Pursuant to N.J.S.A. 40:55D-53(a), an itemized cost estimate for the improvements must be prepared by the municipal engineer**. This information should be sufficient for ensuring that appropriate escrow funds are reserved to cover the cost of inspections that are performed after project close-out.

The escrow law is silent on the issue of **legal fees incurred after the review escrow has been closed-out** and the project is under construction with inspection escrow posted. Such legal fees might include costs incurred for attorney preparation of any extension agreements; review of extensions of performance guarantees; review of deeds for improvements being dedicated to the municipality; etc. **This is a matter that municipalities should try to work out with the applicant**. The following suggestions by attorneys and municipal officials are offered as examples of how post close-out legal fees might be funded. They should not be considered as endorsements by the Division.

- Using flat fees to cover legal costs incurred after project close-out;
- Maintaining an escrow reserve for legal costs incurred after close-out;

- Broadening requirements for inspection fees to include legal work performed after close-out of the review deposit.

C) **ISSUE: What information should be included on the final report?**

COMMENT: The **final quarterly report issued to the applicant should suffice in lieu of a close-out summary** of all transactions that occurred between the opening of the escrow account, and the completion of review and inspection activities.

VI. APPEALS

A) **ISSUE: Time for filing appeals**

COMMENT: Procedures for filing an appeal with the **County Board of Construction Appeals** are defined in N.J.S.A. 40:55D-53.2a.. All appeals (including those made to the governing body) must be filed within the statutory **45-day** period following receipt of a voucher If a voucher is not supplied, appeals can be filed within 60 days of receipt of an accounting statement

Appeals can also be filed for what might be perceived as an ongoing pattern of overcharging In such instances, the appeal may be filed at any time during a six-month period that the overcharging is alleged.

B) **ISSUE: Reimbursing the escrow account after the appeal decision**

COMMENT: **If the applicant wins the appeal,** the applicant's account must be reimbursed by the municipality. The burden is on the municipality to collect any disallowed charges from its contracted professionals. If the professional refuses to reimburse, the municipality must bear the cost of litigation to collect the funds. **The Professional Service Contract should include appropriate language to define protocol and responsibility on this issue**.