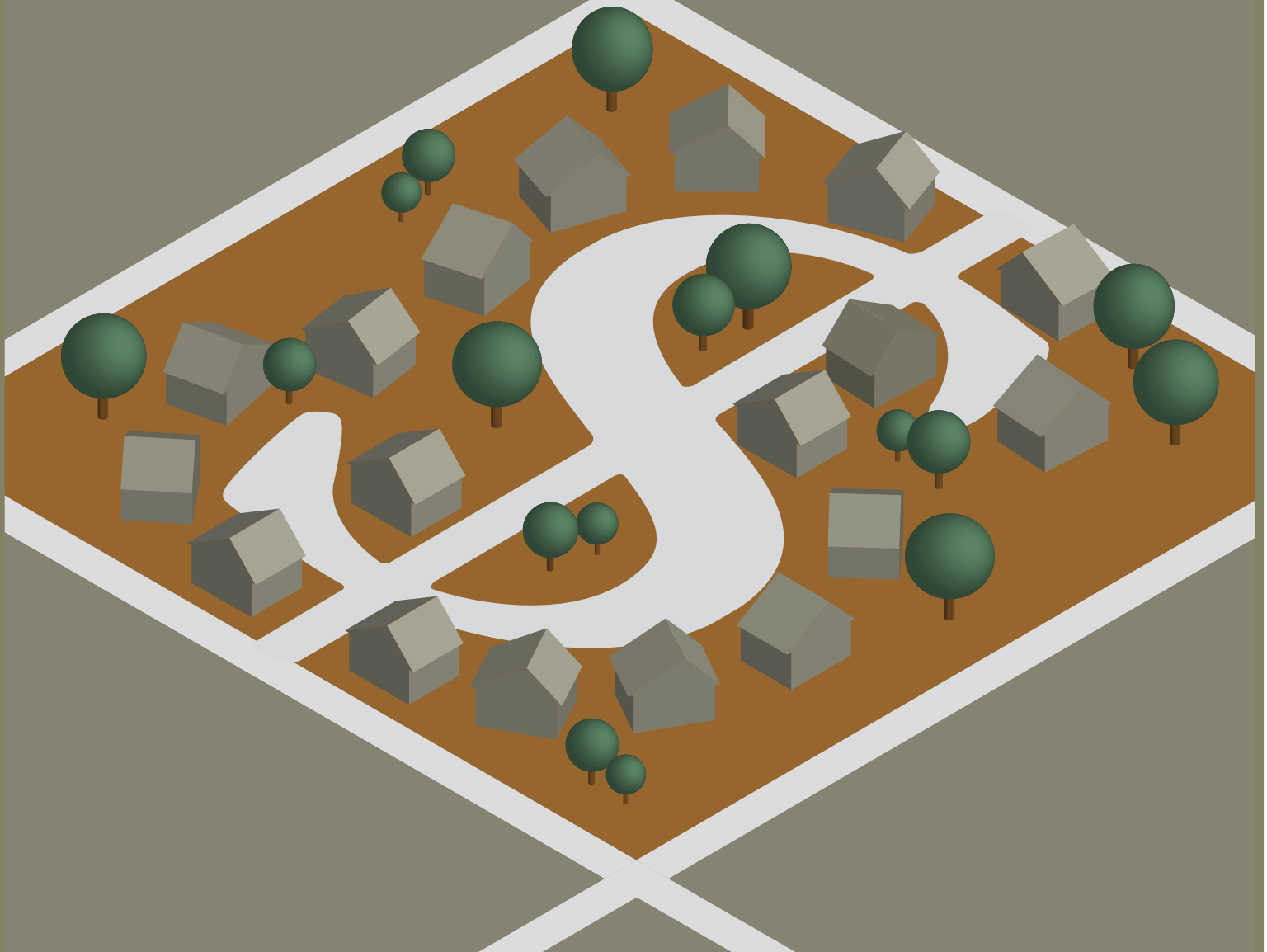


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Fundamental Property Tax Reform: Land Use Implications Of New Jersey's Tax Debate

A Regional Plan Association / Lincoln Institute of Land Policy Partnership Project

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Executive Summary

1

Introduction

4

**New Jersey Property Taxes:
How High, Who Pays?**

6

**Land Use, Housing and
Education**

8

Reform Proposals

9

**Evaluating the
Comprehensive Impacts of
Property Tax Reform**

12

Fundamental Property Tax Reform:

Land Use Implications Of New Jersey's Tax Debate

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Executive Summary

There are good reasons that property taxes are a burning issue in New Jersey. Residents pay more property taxes per person than citizens in any other state, and New Jersey's share of government services paid for by local property taxes is among the highest in the United States. Taxes also vary widely across New Jersey, with rates in the most heavily taxed places more than twice as high as those in the least taxed municipalities. Building dissatisfaction has altered the political scene with everything from calls for a constitutional convention to the emphasis given to property tax relief by both of the major party candidates for Governor.

If property taxes were simply an issue of fiscal policy, then the debate would be a relatively straightforward discussion of the trade-offs between tax rates and service levels. However, the current public debate has largely ignored the pervasive impact that property taxes have on some of the most important issues in the state. By relying so heavily on local property taxes to fund education and other services, New Jersey has created a structure of incentives that work against equitable education spending, as well as the land use goals of the New Jersey State Development and Redevelopment Plan, including open space protection, the production of new housing at a reasonable cost and sustainable economic growth and development.

As cities, towns and villages seek to maximize revenue and reduce costs, they try to attract development that promises short term revenue and lower costs, and shun development that will impose new costs. This has led to overzoning for commercial development, such as malls and office parks, and underzoning for housing. In particular, municipalities often limit zoning for all but age-restricted

housing in order to avoid the costs of educating school-age children. Also, when new development is allowed, it is often in dwindling agricultural and greenfield areas that are less costly to developers and least disruptive to existing residents.

These incentives create a pattern in which the short-term interests of municipalities work against the long-term interests of the state as a whole. Taxes tend to increase most in places that can least afford it – distressed urban areas and older suburban towns where the tax base has shrunk as people have moved out. Here, local governments are forced to increase the tax rate or cut services for the remaining population, which further discourages private investment, pushing it outward to the suburbs and rural fringe. As these areas become alarmed by growing congestion, the loss of open space and rising school costs, they begin to restrict residential development. As the supply of housing is constrained, prices rise and housing becomes less affordable.

In the winter and spring of 2005, Regional Plan Association and the Lincoln Institute of Land Policy organized a series of roundtables to address the land use dimension of property tax reform. The experts and public officials in these forums, both from New Jersey and other states, generally agreed on three broad conclusions:

- **First, the time is right for a thorough discussion of property taxes and proposals that could have far-reaching implications for land use, school reform and state-local relationships.** Regardless of whether there should be or will be a constitutional convention, the issue is front and center in the state's political agenda and there may not be a better opportunity for reform for years.
- **Second, although there have been a number of interesting ideas from public officials, candidates and policy experts, land use impacts have largely been ignored from the discussion to date.**
- **Third, there is no framework for evaluating complex property tax reform proposals in a comprehensive manner.** Other than the issue of how much New Jersey can afford to cut taxes, and for whom, there is no clear set of evaluation criteria or mechanisms for comparing different ideas.

Candidate Positions

Subsequent to the roundtables, RPA requested the Democratic and Republican candidates for governor, Jon Corzine and Doug Forrester, to submit brief statements describing their property tax proposals. Both candidates responded, and **their statements are included on page 11** of the paper.

These proposals reflect both the positive aspects and the shortcomings of the larger public debate. They demonstrate that property taxes are likely to be a priority regardless of who is elected, but both proposals focus almost exclusively on property tax relief. Neither of the candidates' specific proposals involves any structural changes in how property taxes are levied, nor do they examine land use implications for the New Jersey State Development and Redevelopment Plan. They differ largely in who would be targeted for immediate tax reductions or rebates and how much taxes can be cut, while offering few specifics on how the cuts would be paid for. Corzine also calls for a constitutional convention to consider further reforms, while Forrester would constitutionally mandate his proposed reductions. Much of the dispute between the two candidates concerns how much spending can realistically be cut before education quality or local services suffer, and how much can be absorbed by the state government.

This is not to say that these tax relief proposals would not have any impact on land use, but these impacts are largely unexamined. It is not sufficient to assume that any reduction in property taxes would reduce incentives for the pervasive fiscal zoning described here. For example, if localities are still responsible for the costs of new development, then the incentives that have led to current land use patterns could change very little. Before adopting either of the candidates' proposals, the costs and land use implications need to be further specified. More importantly, a broader range of innovative ideas needs to be debated.

Criteria for Evaluating a Broader Range of Ideas

In the course of the three roundtable discussions, several ideas for property tax reform were discussed. Some focused explicitly on tax reform, others on broader fiscal or land use reforms that would have implications for local tax policies. Most of these could be implemented in a "revenue-neutral" fashion, or in combination with other measures aimed at reducing property taxes. These proposals generally fall into one of three categories – state assumption of local cost burdens, regional solutions, or differential property tax classifications.

RPA followed the roundtables with a preliminary assessment of how these ideas might help achieve a range of policy objectives. An important part of this process is establishing the criteria by which different proposals should be evaluated. The following criteria are suggested as a starting point for public debate:

- **Economic efficiency**
- **Flexibility**
- **Consistency with State Plan**
- **Affordable housing**
- **Education equity**
- **Fiscal discipline**
- **Fiscal sustainability**
- **Local autonomy**

Clearly, some of these criteria tend to be relatively compatible with each other, while others have a natural tension. For example, local autonomy could be at odds with education equity and other goals, requiring some trade-offs and good program design to minimize the conflicts. Measuring and weighting the criteria also require a combination of research and value judgments. However, each idea has different potential strengths and uncertainties when matched against these criteria.

• **Cost-based state aid**, which would link state aid to the actual costs that municipalities incur from new development, could significantly reduce municipal opposition to growth. This would likely advance State Plan and affordable housing objectives, but the size of its impacts and its effects on fiscal discipline and state and local budgets would depend on the particulars of the reform proposal.

• **State assumption of education costs** would be one of the most far-reaching reforms that could be enacted and would have the most direct effect on education equity. It would also remove the major incentive for fiscal zoning, advancing economic efficiency, State Plan and affordable housing goals, but its effects on fiscal discipline, local autonomy and state fiscal stability would depend greatly on the design of the program.

• **Smart growth zoning incentives** would provide additional school aid and other funding for municipalities that adopt new zoning and increase density in eligible locations designated by the State Plan. They would have their clearest impact on State Plan goals and affordable housing, but would benefit some places more than others. The net impact would

depend on how the specific incentives interact with the market.

- **Tax-base sharing**, in which municipalities share a portion of property tax revenues, should theoretically distribute education resources more equitably and steer development toward low-wealth urban and suburban centers and away from low-density towns with lower property tax rates. Outcomes can vary greatly in “strong” and “weak” markets and the impacts on fiscal discipline remain controversial.

- **School district consolidation** should create a more equitable distribution of education funds while creating economies of scale that reduce overall costs. This is also likely to steer growth toward districts that now have relatively high property taxes, similar to tax-base sharing. How much it would improve these, and whether it would have any detrimental impact on fiscal discipline and local autonomy are debatable.

- **Split rate taxation** would tax land at a higher rate than new development and reduce disincentives to build where land values are high. Its clearest advantages are economic efficiency and incentives to make land more productive, leading to more housing as well as other development. It could be a mixed blessing for state plan goals, since it could encourage development in both urban markets and on agricultural land.

- **Varying taxes by State Plan designation**, such as the one originally proposed by the SLERP (State and Local Expenditure and Revenue Policy, 1988) Commission, would be tailored to align property taxes with State Plan goals. It should also improve education equity and create incentives for more affordable housing in currently high-tax areas. Its effects on economic efficiency and local fiscal discipline are less clear, and would depend on the specifics of the proposed program.

Another consideration is how politically acceptable these ideas may be, regardless of their other merits. Some would face more intense opposition than others, have more complex issues to resolve and explain, or would take longer to implement. These are legitimate considerations, but should not be used to reject any potential idea out of hand. With the right framework and information, a full public discussion could change the terms of the debate and come up with innovative solutions that address existing concerns.

Before enacting these or any other proposals, New Jersey needs a thorough debate on a full range of reforms that could redress some of the long-standing issues that lead to economic inefficiencies, sprawling development patterns, inequitable education

outcomes and fiscal burdens and, in the long run, higher taxes to buy the same level of service. Public officials, candidates, civic associations and citizens should make the effort to both “cast a wide net” in looking at potential reforms and examine all of their potential implications. We hope that this report will further this discussion.

Introduction

Over the last decade, New Jersey has emerged as a leading state for fiscal reform and land use planning. Now many in New Jersey are examining the possibilities for fundamental changes in the balance between state and local revenue collection. Some argue that this initiative should be undertaken by calling a Constitutional Convention, targeted for 2006; others argue that the legislature can and should address these issues without a convention. The overriding goals of both efforts is to re-write laws and regulations in order to shift the burden of financing public services, in particular education, away from local property taxes and onto some new array of revenues. Some say that reform should be revenue neutral, focusing solely on structural changes to the tax system; others argue that in order to keep taxes down, reform must also include finding ways to cut spending. Of particular concern to RPA and the Lincoln Institute is that any changes should result in reforms that improve fiscal equity and land use, rather than simply reducing property taxes.

New Jersey's heavy reliance on local property taxes results in wide discrepancies in the resources available to different municipalities, and, ultimately, to rising property taxes that hurt lower- and fixed-income households. Heavy reliance on locally-collected property taxes also creates competition among municipalities for development that brings fiscal benefits and an aversion to development that does not. This often leads to perverse land use decisions, including limitations on residential land uses that restrict the supply of housing. Further, the system discourages the types of cooperation needed to keep down costs of providing public services. With 21 counties, 566 municipalities, 611 school districts,

and 400 local authorities and fire districts, New Jersey has a highly fragmented governance structure that keeps the cost of providing public services higher than if some of these services were provided cooperatively.

In response to potential New Jersey legislative action creating a special legislative session or a constitutional convention to address property tax reform, Regional Plan Association and the Lincoln Institute of Land Use Policy are researching policy alternatives to address the state's over-reliance on local property taxes. The project also seeks to identify policies that would make growth areas in New Jersey – for example, in the Somerset Regional Center, town centers in the Highlands, or other parts of the state – accepting of more growth and density.

In a major address in 2004, Governor James McGreevey announced his support for a constitutional convention to address property tax reform. While not specifically mentioning land use implications, the Governor and convention supporters clearly understood the need to change a system that appears to reward sprawl. However, the subsequent property tax debate has paid scant attention to the land use implications of reform. Anticipating the need to inform delegates and/or legislators of the critical necessity to understand these issues, RPA and Lincoln began an effort to research, plan and advocate a better system – one that actually rewards smart growth decisions.

This effort builds on work that RPA and Lincoln conducted in Somerset County over the last decade, where three towns and the county government collaborated with RPA and Lincoln, as well as the private and non-profit sectors to create a vision for the heart of the county. The Somerset Vision Initiative has been identified as a success for its ability to engage the public and produce a common vision of ways to better integrate land use within the three-town regional center. In looking at ways to implement the vision plan, it was clear that the current property tax system creates major disincentives which impede progress. RPA and Lincoln grounded this research in the Somerset Vision project, and used the case study to test ideas and concepts for property tax reform.

Key to this effort has been three roundtable forums and white papers exploring issues and options related to property tax reform. These forums were chaired by prominent public leaders and produced issue reports on fiscal mechanisms for smart growth, fiscal zoning and attainable housing, and differential taxation, to inform the public debate and set the stage for the possible convention, the election campaign and legislative debate.

The format for the panels included a presentation by experts on a policy issue, including specific proposals for policy changes in New Jersey. At the first forum, two respondents from the New Jersey Legislature – a member of each party closely identified with the specific issues – discussed the political

feasibility of the proposals. There were also opportunities for the audience to raise issues and questions. A summary of each roundtable was produced and posted on the RPA web site alongside the white paper for each roundtable, which were held at the following times and locations:

Roundtable 1

How Can We Afford Smart Growth?

Wednesday, February 23, 2005
Bloustein School of Planning and Public Policy
Rutgers University
New Brunswick, New Jersey

Roundtable 2

**How Can Property Tax Reform
Ensure Sufficient School Funding
and Attainable Housing?**

Wednesday, March 9, 2005
The College of New Jersey
Ewing, New Jersey

Roundtable 3

**Should Land and Buildings
Be Taxed Differently?**

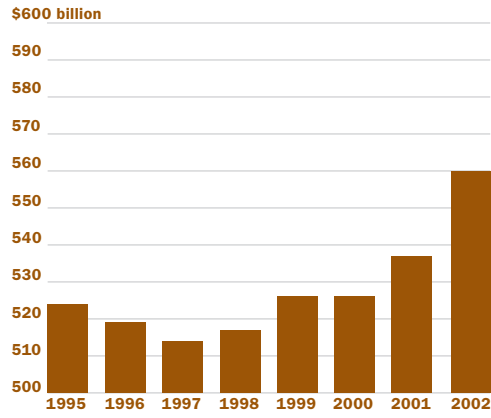
Wednesday, March 23, 2005
The Cornwall Center for Metropolitan Studies,
Rutgers University
Newark, New Jersey

With the assistance of a Steering Committee, RPA and the Lincoln Institute framed the issues surrounding the three roundtables, and engaged officials and citizens in a more comprehensive approach to property tax reform. As you will see from the following report, true property tax reform is not easy, nor is it easily understood. Providing both relief as well as structural reform that will improve land use decisions is a tall task that will require a more sophisticated populace. RPA and the Lincoln Institute hope that this report advances these goals.

New Jersey Property Taxes: How High, Who Pays?

As a share of state and local revenues, New Jersey's ranking for property tax burden drops only slightly. As shown in the table below, property taxes in the state ranks in the top five as a share of both state and local revenues combined and as a share of local revenues. In 2001-2002, 29% of state, county and municipal revenue came from the property tax, ranking it 2nd in the nation. In addition, between 1997 and 2002, the share from property taxes increased from 24% to 29% points. Local government revenue was 49% reliant on the property tax, the 4th highest in the nation. (Federal and state aid accounts for the largest share of the remaining local revenue).

Total Taxable Value of Land and Improvements in New Jersey in 2004 Constant Dollars

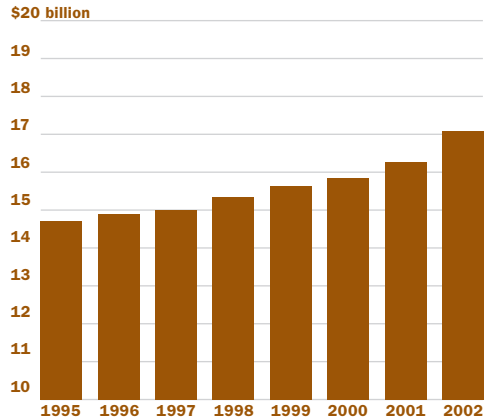


Source: State of New Jersey Division of Taxation

New Jersey's local governments rely heavily on their own sources for revenue, in particular the property tax. In FY01-02, almost 65% of local revenue came from local sources, with over three-quarters of this from local property taxes. The level of local property taxes results from several factors – the services that local governments (as opposed to the state) are responsible for, the level of service demanded by voters, the efficiency with which local governments provide these services, the property wealth that is available to be taxed, and the availability of other revenue sources, particularly state aid to localities.

Whatever the cause, New Jersey residents pay more property taxes than anyone in the U.S. according to some measures. In 2002, property taxes per person (including all residents, whether or not they pay property taxes) ranked 1st among all states at \$1,908. Contributions for all states were \$992 in 2002, only about half of what the average New Jersey resident pays. Between 1997 and 2002 the State experienced a 7.6% increase in per capita property taxes, adjusted for inflation, slightly less than the 8.1% for the U.S.

New Jersey Property Tax Levy in 2004 Constant Dollars



Source: State of New Jersey Division of Taxation

New Jersey Property Taxes as a Share of Total Revenue, FY2001-2002

Government Level	NJ Ranking	NJ Share	All States Range
State and Local Combined	2nd	29%	6% - 32%
All Local Governments	4th	49%	8% - 54%

Source: 2002 U.S. Census of Governments "State and Local Government Finances by Level of Government and by State: 2001 - 02"

Part of the reason for New Jersey's high taxes is the high concentration of wealth compared to other parts of the United States. In 2002 the total taxable value of land and improvements in New Jersey (the tax base) was \$560 billion. This represents an increase of 6% from 1995 in real terms. Over the same period, the property tax levy increased nearly twice as fast, by 13% to \$17 billion.

Local Variation of Property Taxes

The equity issues that infuse discussion of the property tax can be better understood by examining how tax rates vary by income, type of tenure, etc. The following table groups New Jersey's 566 municipalities into three tiers or groups of about 188 municipalities each ranked in descending order, according to its effective tax rate in 2004. The top tier had an average rate of \$3.2 per hundred dollar of assessed value, more than a third higher than the \$2.3 rate for the middle tier and twice the average rate of the lower tier.

Whereas the top tier had the highest effective rates and increased over the period by 2%, the middle and lower tiers actually experienced a decrease between 1998 and 2004. It is significant that the lower tier, for example, has the smallest rate and experienced the largest decrease: -20%. In other words, the gap between municipalities with high tax rates and those with lower rates has been increasing.

Municipalities with the highest tax rates also have the lowest average income and real estate value. Proportionally, localities with the lowest rates have the lowest population concentrations and higher income and property values than the other groups. In sum, the more affluent the municipality the lower the rate and the most significant the decrease it has experienced in recent years. Places with a high share of renters tend to have higher property tax rates, as do municipalities with a high share of minorities.

Nominal Effective Tax Rates and Characteristics of Municipalities in New Jersey, 2004

	Top Tier	Middle Tier	Lower Tier
Average Effective Rate*	3.2	2.3	1.6
Median Effective Rate*	2.96	2.3	1.78
98-04 Percent Change	2%	-11%	-20%
Average Population	16,303	17,832	10,510
Average Income	\$52,706	\$63,099	\$74,444
Average Real Estate Value	\$132,040	\$184,222	\$286,276
Ownership Tenure	59%	63%	78%
White Population	56%	63%	86%

* Tax dollars per hundred dollars of assessed value
Source: State of New Jersey Division of Taxation, U.S. Census SF3

Land Use, Housing and Education

If property taxes were simply an issue of fiscal policy, then the debate over how to set rates and what they should pay for would be relatively straightforward. However, property taxes have an impact on a wide range of public policy concerns – education, housing, the environment and land use. In examining these impacts, it is important to make a distinction between those that result from the incentives and disincentives that flow from taxing property (as opposed to income, consumer sales or other sources of revenue) and those that would result from any local tax. In other words, some of the impacts attributed to property taxes would also result from a local income or sales tax, simply because of the incentives they create for municipalities to maximize their tax base and limit anything that adds to costs. The discussion below attempts to demonstrate how both of these attributes affect land use and development as well as education and fiscal equity.

The structure of the state's property tax system creates incentives that work against the goals of the New Jersey State Plan. Mostly, this is due to the needs of municipalities to maximize revenues and reduce costs, which would come with any system that relies on local taxation. However, the particular structure of the property tax exacerbates these incentives. New Jersey is a Home Rule state, where municipalities have enormous control over land use. Not surprisingly, they use this control to attract development that promises short term revenues and lower costs, and to shun development that will impose new costs. It is commonly believed that the most lucrative development types tend to be commercial and retail properties, while residential development is often the biggest drain financially. A study of several New Jersey municipalities by the American Farmland

Trust found that for every dollar in revenue brought in by residential development, \$1.14-1.51 in costs were generated. Commercial and industrial properties, on the other hand, cost only \$0.17 to 0.34 for every dollar in revenue; agriculture and open land costs \$0.33-0.66 for every dollar in revenue.

These financial incentives have a significant effect on New Jersey's built environment. Municipalities overzone for commercial development, such as malls and office parks, and underzone for housing, especially multi-family housing. They often locate commercial zones in places that promise to be most attractive to developers and least disruptive to current residents – this tends to be on greenfields, far from existing development. Local open space protection programs, too, can be used to avoid residential development and – when not part of a larger regional open space plan – can push development outward, creating leapfrog patterns of growth. Meanwhile, municipalities often limit zoning for all but age-restricted housing in order to avoid the costs of educating school-age children, which, on average, accounts for over half of local expenditures in New Jersey.

Moreover, the current tax system creates competition among municipalities that exacerbates inequities. Those who lose tend to be those who can least afford it: distressed urban areas, where the tax base has shrunk as people have moved out. Here, local governments are forced to increase the tax rate on the remaining population (which tends to be less able to pay high taxes, and more in need of services). Higher tax rates further discourage investment, pushing it outward to the suburbs and rural fringe, where tax rates tend to be lower.

The effects on land use, affordable housing and education are also intertwined. Housing prices will continue to rise as towns disallow residential development. As supply is constrained by municipalities avoiding school costs, housing throughout the state will become less affordable. The dilemma in New Jersey is not unique among states. Although New Jersey has the greatest reliance on local property taxes by many measures, other states have been faced with inequitable distribution of funding for public schools, high property taxes, and the downward spiral of disinvestment in poorer areas that results.

One approach to the problem is to cap property taxes, and force elected officials to find different sources of revenues. But limiting property taxes can lead to under-funding public schools. In California, Proposition 13 (1978) famously limited property taxes as a percent of assessed value. Property tax revenues fell dramatically. Ten years later, Proposition 98 guaranteed a minimum level of funding for public schools. The overall result of both measures has been plummeting educational quality, lower spending per pupil, declining local services, and increased local sales taxes. California's fourth grade reading levels outperform only Louisiana's, it has the worst eighth grade math scores in the nation, and local services such as hospitals and county jails have been scaled back dramatically due to lack of funding which had previously come from property taxes.

Before examining reform proposals that could address these shortcomings, it should also be noted that property taxes have some positive attributes that may be worth retaining. The most important is fiscal stability. While most other state and local revenue sources are either cyclical (income and sales taxes) or dependent on the politics of higher levels of government (intergovernmental aid), property taxes are relatively stable through both recessions and expansions and are completely under the jurisdiction's control. Therefore, they can be an important part of a "balanced portfolio" of state and local taxes. Also, in theory, property taxes can be an important part of a progressive tax structure by taxing wealth that falls outside of income or consumption-based taxes. In practice, however, the reliance of localities on property taxes means that poorer jurisdictions will be taxed higher than wealthier ones.

Reform Proposals

Not surprisingly, the political debate thus far has focused almost exclusively on the question how much property taxes can be reduced. This is the bottom line for most voters, with the question framed in terms of how lower property taxes would affect different constituencies and state and local budgets. Any broadening of the discussion needs to demonstrate how alternative proposals can at least be consistent with the goal of minimizing overall tax burdens. These proposals also need to demonstrate how they will bring additional benefits in terms of land use, efficiency and other criteria. Before turning to the question of how to evaluate different proposals, it is helpful to outline proposals that surfaced during the roundtable discussions, as well as those that have been proposed by the major candidates for Governor.

Roundtable Proposals

In the course of the three roundtable discussions, several ideas for property tax reform were discussed. Some focused explicitly on tax reform, others on broader fiscal or land use reforms that would have implications for local tax policies. Most of these could be implemented in a “revenue-neutral” fashion, or in combination with other measures aimed at reducing property taxes. For example, spending caps, such as those suggested by Senate Minority Leader Leonard Lance in the first roundtable, could potentially be implemented along with many of the structural reforms below. These proposals, described briefly below, generally fall into one of three categories – state assumption of local cost burdens, regional solutions, or differential property tax classifications.

State assumption of local costs

● **Cost-based state aid:** Paul Gottlieb, in the first roundtable, described the problem that aid to localities from state programs generally does not increase proportionately with municipal costs. Either there is no relation to local growth, or aid is based in per capita formulas, such as per pupil expenditures, that are not a reliable measure for how much local costs increase with new growth and development. As such, current state aid formulas are a very inefficient way of reducing incentives for “ratable shunning,” the anti-growth sentiment that many participants described as a more serious problem of fiscal zoning than “ratable chasing.” The solution would be to revise aid formulas to cover a percentage of the increased costs that municipalities incur when they take on additional development or other activities that the state wants to encourage.

● **State assumption of education expenses:** If the revision of state aid formulas can be considered an incremental reform, the state assumption of all expenses for public elementary and secondary education would be a radical departure from current practices. However, such a change is not without precedent. In fact, there is a national trend in which states are assuming a larger share of education expenses. Michigan is the leading example, having “blown up” their locally-based system of education finance in 1993 and replaced it with a state sales tax. As described by Douglas Roberts in Roundtable 2, the change has greatly improved school equity as the spending gap between wealthiest and poorest schools has narrowed considerably. The Michigan experience points to several issues that New Jersey would need to confront in making such a change. In addition to the political hurdles, the challenge of determining an acceptable formula for allocating state funding is considerable, and alternative revenue sources, such as Michigan’s sales tax, may not be as stable. However, such a change would largely remove the perverse incentives of local taxation on land use decisions.

● **Smart growth zoning incentives:** A more incremental approach that ties state aid to smart growth measures has been evolving in Massachusetts over the last couple decades. Described by Edward Carman in Roundtable 2, property tax increases have been regulated by the state and are quite low compared to New Jersey. Education funding has also gone through a reform process and is more equitable than in New Jersey. The latest reform, Chapter 40R, provides priority for state infrastructure investments to municipalities that adopt new zoning regulations and increase density in eligible smart growth locations, and a proposed provision, Chapter 40S, would reimburse for additional school costs. With a state plan already in place, New Jersey could adopt this reform using existing state plan designations.

Regional Solutions

● **Municipal tax-base sharing:** This approach, mentioned by several participants, would in theory increase government efficiencies and reduce the pressures for fiscal zoning by having municipalities share a portion of the tax revenues created from new or existing development. As such, it would affect property tax rates and revenues for individual localities, and create greater equity between towns. National examples are relatively few, but include the New Jersey Meadowlands. Since this is a foreign concept for most municipal governments and tax payers, who must overcome the fears of being a net “loser” and losing local control, strong state incentives would probably be needed for this to occur. An incremental step would be to increase the responsibilities and taxing authorities of counties, which are already a de facto form of regional government.

● **School district consolidation:** This regional approach focuses on the cost side, with the intent of reducing education costs by consolidating school districts and creating efficiencies of scale. A specific proposal made by State Senator Bob Smith at the first roundtable would consolidate the state’s 616 school districts at the county level. School district consolidation proposals have been made previously in New Jersey and rarely get much traction. As in other states, citizens are reluctant to give up districts with which they strongly identify or their control of local schools. The question is whether dissatisfaction with property taxes has reached a point where a well-crafted concept could be sold to the voters.

Differential Property Tax Classifications

● **Split-rate taxation:** The focus of the third roundtable – taxing land and buildings at separate rates – would be a major structural departure from how New Jersey and most of the nation levies property taxes. In theory, taxing land at a higher rate than new development would reduce disincentives to build where land values are high (presumably in areas favored by smart growth criteria). It should also be fairer, preventing windfalls to landowners who benefit from public improvements or the investments of their neighbors. The only large-scale national example, Pennsylvania, and several international examples indicate that this reform would have a positive impact on both efficiency and equity. However, as described by David Brunori, there are few other policies that have such universal support among economists combined with practically no support in the political arena. Even incremental implementation would require extensive public education and discussion of a complicated topic.

● **Varying taxes by State Plan designation:**

This concept, described by Paul Gottlieb in the first roundtable and further analyzed in his paper with Henry Coleman, would charge lower property taxes in locations where the state plan wants to encourage development and higher taxes where growth is to be discouraged. One specific version, first proposed by the State and Local Expenditure and Revenue Policy (SLERP) Commission in 1988, would tax all new construction at a state-mandated rate that would vary by state plan “tier.” Any revenue collected above what would normally have been collected under local rates could either be redistributed to areas whose rates were effectively lowered, or used for state-wide infrastructure improvements. Since the proposal was not enacted, the question is whether an additional 17 years experience with the state plan and continued increases in property taxes since then might give it any more political viability.

Gubernatorial Candidate Proposals

In addition to the proposals discussed at the roundtables, RPA requested statements from the Democratic and Republican candidates for governor, Jon Corzine and Doug Forrester, to submit brief statements describing their property tax proposals. Both candidates responded, and their statements are shown in full below.

Both proposals focus on property tax reduction, but differ in who would be targeted for immediate tax reductions or rebates, how much taxes can be cut, and whether or not a constitutional convention is needed to consider further reforms. While offering few specifics on how the cuts would be paid for, both focus on reducing “wasteful spending.” Much of the dispute between the two candidates concerns how much spending can realistically be cut before education quality or local services suffer.

It is fair to say that neither of the proposals for immediate property tax reduction addresses the structural issues identified in this paper – how property taxes are levied, how state and local responsibilities could be restructured, how the incentives of the tax system could be better aligned with the goals of the State Plan. This is not to say that these proposals would not have any impact on land use. To the extent that they result in lower local taxes – either by eliminating spending or shifting tax burdens to state taxes – they could reduce incentives for fiscal zoning by municipalities. However, this outcome is by no means assured, and the questions of where and how development patterns could change are largely unexamined. For example, if property tax cuts result in equivalent reductions in local services, then new development is likely to be attracted to the same places it is now. And without changing local government’s responsibility for education spending and other services, there will still be strong incentives for discouraging development that brings new costs.

Jon S. Corzine

Statement on Property Taxes for Regional Plan Association

As property taxes go up every year, more and more New Jersey residents are finding that life is becoming unaffordable. New Jersey's over-reliance on property taxes also has harmed our state in other ways, such as fueling the "ratables chase" that leads to sprawl and poor land-use decisions. To make matters worse, the property tax is one of the most unfair taxes because the burden falls hardest on those least able to pay.

Election-year slogans or pie-in-the-sky promises won't solve the property tax crisis. What will solve it are tough-minded leadership and a real plan to reduce our reliance on property taxes and ease the property tax burden, especially for seniors and low- and middle-income families. I will provide that kind of leadership, and I have a real plan to solve the problem.

My plan recognizes that the property tax crisis is the result of structural problems that have developed over many years involving fundamental questions about how our schools and local governments are organized and financed. My plan also recognizes that our goal must be to maintain excellence in our public schools and ensure high-quality local government services while funding them with a tax system that is fair and more responsive to an individual's ability to pay.

As to the best process for achieving this goal, I believe it is the Legislature's responsibility to reform our tax structure, and that's why, if I am elected, I will call a Special Session of the Legislature to tackle the property tax problem. I also believe that, in order to build public and legislative support for the kind of fundamental reforms that are needed, we will have to more directly involve the public in the reform process. Otherwise, either the Legislature will not vote for the reforms, or there will be damaging voter backlash if the Legislature approves reforms that the public did not have a role in creating and does not endorse. I believe that one way to directly involve the public and actually achieve the reforms we need is through a citizens' property tax convention. Without the overhang of the convention, the Legislature probably will do what it has always done, which is to avoid making the necessary decisions to reform our funding system for fear of a voter backlash.

My plan also includes immediate relief targeted to the millions of New Jersey taxpayers who need it most – seniors and low- and middle-income families – through rebates that will grow by 10% each year – 40% over four years. To pay for the plan, I will cut wasteful spending, eliminate the "corruption tax," and implement my strategy to invest, grow, and prosper by creating thousands of jobs, which in turn would generate hundreds of millions in new revenues each year without new taxes.

We also need to control the growth in local spending by adopting workable budget caps and improving incentives for shared services, using leveraged purchasing power, and encouraging voluntary regional or consolidated approaches to delivering government services.

Doug Forrester

Statement on Property Taxes for Regional Plan Association

New Jersey is in the midst of a fiscal crisis. Corruption and wasteful spending are out of control, and as a result, property taxes are skyrocketing. This combination leaves New Jersey families and seniors overburdened under the tax weight – so much so that they are being driven out of the state.

My property tax relief plan is exactly what we need to reduce the property tax burden on New Jersey's hard-working families and seniors. The 30%-in-3 Guarantee will lower property taxes in New Jersey by 30% over three years, guaranteed by the state constitution.

The plan provides a 10% property tax cut in the first year, a 20% cut in the second year, and a 30% cut in the third year. In the third and every year going forward, 30% of your property tax bill will be paid for by the state.

The plan provides an automatic rebate that is guaranteed by the State constitution, unlike current rebate programs that have a history of being politically manipulated, cut or suspended. The 30%-in-3 Guarantee also creates a Property Taxpayer's Protection Fund that can be used to maintain property tax relief during lean economic years.

My 30%-in-3 Guarantee will lower property taxes by 30% because it forces the state to make property taxpayers the number one priority – the state will be forced cut wasteful spending to pay property taxpayers first.

Reducing property taxes will play a large part in encouraging smart growth and affordable housing. By ensuring tax relief for New Jersey's homeowners and tenants – which are included in my plan – we will make New Jersey affordable. By preventing New Jerseyans from having to leave the state on account of their property tax burden, we will continue to grow the economy, which is the best way to increase affordable housing options.

The plan gives tools to local governments and school districts to keep their spending down so that property taxes do not continue to rise. By requiring state procurement standards, and minimizing administrative costs, we will ensure that our educational systems and local governments can serve the people of New Jersey.

I believe that we can accomplish real property tax reform in the legislature because the people of New Jersey have had enough, and are demanding that their leaders make a change. Property tax reform begins with ending the spending addiction in New Jersey government. New Jersey government must return to serving the people – not political bosses and cronies.

My plan is not a solution for property taxes alone – it is a new way of running New Jersey. I am a businessman, and I know how important it is to provide a government that people can count on. By eliminating wasteful spending, and rooting out corruption, we will not only lower property taxes, we will make government work for the people again – ensuring that the State plan is free of political influence and ensuring that we are properly planning for the next generation.

Evaluating the Comprehensive Impacts of Property Tax Reform

Despite a diversity of proposals and points of view, roundtable participants generally agreed on a number of points. First, the time is right for a thorough discussion of property taxes and proposals that could have far-reaching implications for land use, school reform and state-local relationships. Regardless of whether there should be or will be a constitutional convention, the issue is front and center in the state's political agenda and there may not be a better opportunity for reform for years. Second, land use impacts have largely been ignored from the discussion to date, and it will take a substantial effort to insert this issue into the debate. Third, there is no framework for evaluating complex proposals in a comprehensive manner. Other than the issue of how much New Jersey can afford to cut taxes, and for whom, there is no clear set of evaluation criteria or mechanisms for presenting unbiased, apples-to-apples comparisons.

To create an evaluation framework, the first step is to obtain agreement on the criteria for appraising different ideas. These criteria should be measurable and broad enough to cover the interests of a variety of constituencies and policy concerns. While any number of criteria might be considered, the following are offered as a way of opening the discussion.

Criteria for Evaluating Property Tax Proposals

- **Economic efficiency:** An efficient tax is one that imposes the least possible distortion on market forces that determine where development should take place. For example, a tax that works at cross purposes with where people want to live and work (or provides people with unneeded rewards

for doing what they would have anyway) is less efficient than one that is “economically neutral.”

- **Flexibility:** The tax should ideally work equally well in strong and weak markets. In other words, it should support the same goals of efficiency and equity when demand is strong as when it is weak. For example, tax abatements for new developments may be effective in places or periods when demand is weak, but inefficient and expensive when it is strong.
- **Consistency with State Plan goals:** On the whole, property tax policies should encourage growth in urban areas, suburban centers and other areas designated by the state plan for growth, and they should discourage growth in environmentally sensitive and agricultural areas.
- **Consistency with affordable housing goals:** In addition to working in sync with State Plan goals for where growth should occur, it should also expand affordable housing statewide to address the large and widely recognized gap between need and supply.
- **Education equity:** Property tax reform also needs to address one of its precipitating causes, the need to provide adequate and equitable school funding across jurisdictions.
- **Fiscal discipline:** Taxes should be structured in a way that encourages government to provide services efficiently, and thereby limit the tax burden on property holders. This principle should also apply to any other state and local taxes that are used as a substitute for property taxes.
- **Fiscal stability:** Over the long run, taxes should be fiscally sustainable and provide a stable source of revenue to support needed services.
- **Local autonomy:** Local control over services and quality of life should be retained as much as possible.

Clearly, some of these criteria tend to be relatively compatible with each other, while others have a natural tension. For example, the goal of reinforcing the State Plan should be compatible with the goal of encouraging affordable housing, but may be at odds with principles of economic neutrality, at least in the short-term. Indeed, one of the difficulties is sorting and weighing short-term versus long-term goals. If properly constructed, the State Plan should reinforce long-term interests by maintaining and creating the types of communities where people want to live. Similarly, local autonomy could be at odds with education equity and other goals, requiring some trade-offs and good program design to minimize the conflicts.

Measuring and weighting the criteria also require a combination of research and value judgments. However, the simple act of considering the implications of different proposals for each of these benchmarks lead to a better understanding of their relative merits. The matrix shown on the next page is one way of conceptualizing the task. It shows some preliminary judgments for how the reform proposals identified in the roundtables would likely affect the criteria listed above. It is important to note that these rankings are only a starting point for further research and discussion. To use this tool to evaluate specific proposals, several steps would need to be undertaken:

- 1) The details for each proposal would need to be specified. The actual impacts will depend on how broadly or narrowly the reform is defined, which categories of property owners are affected, how the mechanism would be implemented and other specifications.

2) Real impacts would need to be calculated for different constituencies – owners vs. renters, residential vs. commercial owners, different income levels and different types of communities.

3) The different criteria would need to be weighted to reflect the state’s priorities. This is a political rather than a technical exercise. For example, how do you choose between a proposal that would achieve greater economic and land use efficiency vs one that delivers greater fiscal stability and discipline? Research and analysis can clarify the choices by showing how large the differences really are, but cannot determine which attributes are more important.

Preliminary Evaluations of Property Tax Reform Categories

As shown by the number of “unclear” entries in the table, even these preliminary assessments are difficult to make without taking these additional steps. However, the different categories of reform do show different tendencies for the kinds of impacts that they would be likely to achieve:

- **Cost-based state aid**, by linking aid to the actual costs that municipalities incur from new development, could significantly reduce municipal opposition to growth. This would likely advance State Plan and affordable housing objectives by encouraging growth in urban and suburban centers, and would generally make the economy more efficient by reducing impediments to market-driven development. How big an impact it would have, and whether it would have any effect on the distribution of education funding or overall fiscal conditions, would depend on the particulars of the reform proposal.

- **State assumption of education costs** would be one of the most far-reaching reforms that could be enacted. It would have the most direct effect on education equity, but even here the impact could vary greatly depending on how funds are distributed back to school districts. It would also remove the major barrier to fiscal zoning, advancing economic efficiency, State Plan and affordable housing goals. The big-

gest potential drawbacks are how this would affect local autonomy over schools, fiscal discipline at the district level and fiscal stability for the state. These would depend greatly on the design of the program.

- **Smart growth zoning incentives** would have their clearest impact on State Plan goals and affordable housing. Indeed, this reform is designed with these objectives in mind. It could also have a positive impact on education equity and the fiscal sustainability of municipalities, but would clearly benefit some places more than others. The net impact would depend on how the specific incentives interact with the market.

- **Tax-base sharing by municipalities** should theoretically reduce pressures for fiscal zoning, distribute education resources more equitably, and steer development toward low-wealth urban and suburban centers and away from low-density towns with lower property tax rates. There is evidence from the limited number of existing tax sharing models to support this, but outcomes can vary greatly in “strong” and “weak” markets and the impacts on fiscal discipline remain controversial.

- **School district consolidation** should create a more equitable distribution of education funds while creating economies of scale that reduce overall costs. This is also likely to steer growth toward districts that now have relatively high property taxes, similar to tax-base sharing. How much it would improve these, and whether it would have any detrimental impact on fiscal discipline and education quality are debatable. How much local autonomy would be lost depends on the specifics of the proposal.

Preliminary Evaluations Property Tax Reform Categories

	Economic Efficiency	Flexibility	State Plan	Affordable Housing	Education Equity	Fiscal Discipline	Fiscal Sustainability	Local Autonomy
Cost-based state aid	Yes	Yes	Yes	Yes	Yes	Unclear	Unclear	Neutral
State assumes education costs	Yes	Unclear	Yes	Yes	Yes	Unclear	Unclear	Unclear
Smart growth zoning incentives	Unclear	Neutral	Yes	Yes	Unclear	Neutral	Unclear	Neutral
Tax-base sharing	Yes	Unclear	Yes	Yes	Yes	Unclear	Unclear	Neutral
School consolidation	Yes	Neutral	Yes	Unclear	Yes	Unclear	Yes	Unclear
Split-rate taxation	Yes	Yes	Unclear	Yes	Unclear	Neutral	Neutral	Neutral
State Plan variation	Unclear	Unclear	Yes	Yes	Yes	Unclear	Neutral	Neutral

- **Split rate taxation** probably has the most variance in its possible outcomes because of the numerous ways it could be structured. However, its clearest advantages are economic efficiency and incentives to make land more productive, leading to more housing as well as other development. It could be a mixed blessing for state plan goals, since it could encourage development in both urban markets and on agricultural land.

- **Varying taxes by State Plan designation**, such as the one originally proposed by the SLERP Commission, would be tailored to align property taxes with State Plan goals. It should also improve education equity and create incentives for more affordable housing in currently high-tax areas. Its effects on economic efficiency and local fiscal discipline are less clear, and would depend on the specifics of the proposed program.

From “Relief” to “Reform”

The need for property tax relief is real and understandably high on the public’s agenda. However, before enacting appealing relief proposals, New Jersey needs a thorough debate on a full range of reforms that could redress some of the long-standing issues that lead to economic inefficiencies, sprawling development patterns, inequitable education outcomes and fiscal burdens and, in the long run, higher taxes to buy the same level of service. Public officials, candidates, civic associations and citizens should make the effort to both “cast a wide net” in looking at potential reforms and examine all of their potential implications.

Regional Plan Association and the Lincoln Institute of Land Policy will encourage this discussion by elaborating on the ideas and framework included in this report. This will include further specification of the policy ideas presented at the roundtables, developing measurable benchmarks for the proposed criteria, and analyzing how these proposals would affect communities throughout the state, from distressed cities to growing exurbs. We hope that this will provide a more informed basis for a public discussion and legislative action.

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Regional Plan Association (RPA) is an independent regional planning organization that improves the quality of life and the economic competitiveness of the 31-county, New York-New Jersey-Connecticut region through research, planning, and advocacy. Since 1922, RPA has been shaping transportation systems, protecting open spaces, and promoting better community design for the region's continued growth. We anticipate the challenges the region will face in the years to come, and we mobilize the region's civic, business, and government sectors to take action.

RPA's current work is aimed largely at implementing the ideas put forth in the Third Regional Plan, with efforts focused in five project areas: community design, open space, transportation, workforce and the economy, and housing. For more information about Regional Plan Association, please visit our website, www.rpa.org.

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