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Fundamental Property Tax Reform II: A Guide for Evaluating Proposals

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

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Reform Scenarios Rated by Criteria	Reform Scenario				
	Vary by State Planning Area	Statewide Rate	Countywide Rate	Income Tax Substitution	Split Rate Taxation
Land Use and Social Equity					
Consistency with State Plan	High	Moderate	Moderate	Moderate	High
Housing Affordability	Moderate	Moderate	Moderate	High	High
Education Equity	High	Low	Low	High	Moderate
Efficiency and Fiscal Health					
Flexibility	High	Low	Moderate	Moderate	High
Fiscal Discipline	Moderate	Moderate	High	Low	Moderate
Fiscal Stability	Moderate	Moderate	Moderate	Low	Moderate
Local Autonomy	Low	Low	Moderate	High	High

Summary

Property tax reform and school spending were two of the most important issues during the 2005 gubernatorial election and, in 2006, New Jersey elected officials are likely to consider specific legislation or constitutional amendments for reform. A widespread desire for relief from some of the highest property taxes in the nation is the driving force, but that is far from the only objective. High property tax rates are seen as damaging the economic competitiveness of the state and exacerbating inequities between property-rich and property-poor municipalities. New Jersey's heavy reliance on local property taxes also leads to perverse land-use decisions by causing municipalities to shun otherwise beneficial housing development for fear of higher taxes, and to compete for an overabundance of other development that brings in net fiscal benefits. While there have been many general calls for reform, and some detailed proposals have been promoted, the debate thus far has lacked a fundamental framework for comparing proposals. This study attempts to fill that gap by comparing the potential impact of a range of revenue-neutral school property tax reforms across a set of established criteria. To demonstrate the usefulness of this approach, five ideas for reform are evaluated. While these by no means exhaust the range of potential reforms, they include several prominent ideas and are sufficiently varied to demonstrate that the criteria can be used to compare very different concepts.

(Proposal 1) Vary the school property tax by state planning areas. This scenario would decrease school property taxes in places where the State Plan would encourage growth (such as planning areas 1 and 2 in urban and suburban centers), and increase taxes in the rest of the state to discourage growth there (such as fringe, rural and environmentally sensitive areas).

(Proposal 2) Collect all school property taxes at one statewide rate. This scenario would make all municipalities' school property tax rates identical, under the assumption that the funds would be redistributed and municipalities' spending on schools would not change.

(Proposal 3) Collect all school property taxes at a county rate, and consolidate school districts at the county level. This proposal would replace local school property taxes with a countywide tax, and consolidate all 611 school districts into 21 county-level school districts.

(Proposal 4) Substitute half the property tax with an income tax surcharge. Under this proposal, also known as NJ SMART, each resident's school property tax would be reduced by half. Municipalities would be reimbursed by the state for the decrease in property tax revenue. The state would raise the revenue for these reimbursements with a statewide surcharge to the income tax.

(Proposal 5) Split the school property tax rate into a higher land tax and a lower tax on buildings and improvements. This scenario proposes taxing land and property at different rates, with land taxed more heavily. Taxes on built properties would decrease to create a revenue neutral result at the municipal level.

Each of these proposals has its own set of intentions and theoretical underpinnings. Some are geared toward stopping sprawl, for example, while others are intended to create a fairer tax system or to ease the school tax burden on poorer municipalities. To gauge the full effect of each proposal, the five ideas are assessed, in both quantitative and qualitative terms, according to a set of seven public-policy criteria previously outlined in an RPA study, "Fundamental Property Tax Reform: Land Use Implications of New Jersey's Tax Debate," (October 2005, www.rpa.org).

- Consistency with State Plan goals
- Consistency with affordable housing goals
- Education equity
- Flexibility
- Fiscal discipline
- Fiscal stability
- Local autonomy

By measuring each proposal according to the criteria, the study attempts to determine how much school property taxes and other taxes would change under each proposal, how these changes would be distributed across 566 municipalities throughout the state, and how each proposal would change the incentives for investing in housing and other types of development, for preserving open space, and for spending on education and other local services.

While no proposal is perfect, the analysis indicates which proposals perform best across a range of objectives. Some, such as the proposals to shift to a statewide or countywide school property tax rate, would have a limited impact on improving land use and social equity without additional reforms to state grant programs. Others, including the proposal to vary taxes by State Plan category and the income tax substitution proposal, would have positive effects on affordable housing and education equity criteria but mixed effects on efficiency and fiscal health. The split rate taxation proposal receives the highest marks across criteria, however it would require a dramatic restructuring of how property is taxed, and the long term effects are difficult to test.

When each proposal is examined closely, it is clear that the details of implementation – which are not discussed at length in this report – would have a large effect on the proposals' impact on the state. Political viability is another important measure which this study does not directly address. The study concludes with a recommendation to incorporate this or a similar framework into the legislative process that will select and enact comprehensive reforms.

Introduction

In 2006, New Jersey is likely to see its property tax debate enter a more decisive phase. The gubernatorial race is over and Governor Corzine has delivered a sobering budget message that addresses the state's immediate fiscal crisis. While the tough choices in this budget will undoubtedly be the legislature's primary focus for the next few months, there is little question that property tax reform is the next major issue on the minds of the Governor, legislators and local officials throughout the state. The Governor himself confirmed this with one of the closing points in his budget address: "In fact, as soon as we close out the difficult debates of the budget season, we must move expeditiously to address the most pressing issue on the public's mind: fundamental property tax reform."¹

But what does fundamental reform mean, and how do we know it will achieve the many ambitious expectations that have been raised, including tax relief, greater fairness, fiscal responsibility and a stronger economy? There is no shortage of proposals for fixing the property tax system, and more will undoubtedly be made as the debate heats up. Groups such as the Coalition for the Public Good have done an admirable job of educating citizens on the issues, identifying goals and pushing for true reform. But there is still no agreed-upon framework for evaluating numerous and dissimilar proposals.

Over the last two years, Regional Plan Association and the Lincoln Institute of Land Policy have attempted to fill this void through a series of reports and roundtables. This report is the third in a series. The first, "Fiscal Policies and Smart Growth: The Case of the Somerset Regional Center," by Henry A. Coleman and Paul D. Gottlieb, examined the potential for various types of property tax reform

to support New Jersey's Smart Growth policies by examining their potential impact on the goals for a new multi-municipal suburban center in Somerset County. The second, "Fundamental Property Tax Reform: Land Use Implications Of New Jersey's Tax Debate," (October 2005) described the findings of a series of roundtables on land use and property tax reform, and provided a set of criteria by which to assess a broader range of ideas.

This report takes the next step by demonstrating how the criteria described in the October report can be used to evaluate detailed proposals for reforming the school property tax system. Five proposals are assessed using both quantitative benchmarks and reasoned judgments. The proposals focus on school property taxes only, however each proposal could be applied to other municipal or county taxes. The five proposals by no means exhaust the potential ways of improving the tax system, nor were they selected because they are necessarily superior to other ideas. Rather, they represent a wide range of approaches that test the utility of the criteria and readily available data. They do, however, reflect one particular objective of this project: demonstrating the potential for property tax reform to improve land-use decision-making – along with the more commonly recognized goals of tax relief and social equity. Two of the five reforms – varying taxes by State Plan category and a split-rate system that would tax land more than buildings and other improvements – explicitly make land-use reform a primary goal. The others – substituting local property taxes with income taxes, a statewide property tax or countywide taxes – would theoretically have a strong land use impact as well.

There is a widely recognized connection between local property taxes and land use. 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 with it fiscal benefits. This often leads to perverse land-use decisions, including limitations on residential land uses that restrict the supply of housing. This property tax effect is exacerbated by a highly fragmented governance structure of 21 counties, 566 municipalities, 611 school districts, and over 400 local authorities and fire districts. This structure not only impedes rational land-use planning and development, it also keeps the cost of providing public services higher than if some of these services were consolidated or provided cooperatively.

What the Report Does and Does Not Address

Many concepts have been proposed to make the property tax system fairer, less burdensome and more efficient. The analysis demonstrates the probable outcomes of several of these concepts in more con-

crete terms by showing how the distribution of taxes would change among different types of localities and how these changes would affect the incentives of different actors, from homeowners to developers to local officials.

To demonstrate these effects, the analysis assumes that each of the proposals is revenue neutral. That is, that the total revenues generated by the proposals are the same as the total revenues generated under the current system. Therefore, the report does not consider the impact of spending reductions that could reduce the burden of taxes overall. All of these proposals could work in combination with measures to limit spending. However, measuring those impacts would also require specifying what type of spending would be cut. For example, a cap on the rate of growth in property taxes without any substitute revenue source would trigger spending reductions that are difficult to identify in advance, since each locality would determine where and how to address the revenue restrictions. Changes in incentives for where families move and how aggressively localities seek new commercial and residential development will depend on what measures are taken. Even a revenue neutral approach, however, can impact both revenues and spending over the long run. Some are likely to be more economically efficient or lead to greater fiscal discipline, which are examined in the report and could increase economic growth or provide services at a lower cost.

The report also does not consider reforms to how properties are assessed, how collections are made or other administrative reforms that could greatly impact the fairness and effectiveness of the system. These are important issues, but are beyond the scope of this project, which focuses on policy rather than administration.

Finally, the analysis assumes that current federal and state grant programs to localities will remain unchanged. It is important to recognize how important these grants are to local revenues, even though New Jersey relies more heavily on local property taxes than almost any state in the country. For example, about 40% of local school funding comes from state grant programs. To some extent, this mitigates disparities between wealthy and poor school districts, but it also creates a complex combination of grant programs that affect the overall equity and efficiency of school expenditures and outcomes. Ultimately, any reform of local school property taxes needs to consider what complementary changes are needed in state grants to localities as well.

¹ Governor Corzine's Budget Address, March 21, 2006, www.state.nj.us/budget06/speech.html.

Criteria for Evaluating Reform Proposals

How are citizens, or public officials for that matter, to weigh very different reform ideas with complex, far-reaching implications? Regional Plan Association and Lincoln Institute's October 2005 report, "Fundamental Property Tax Reform", identified criteria for determining how well reform proposals would meet a diverse set of public goals, from education equity to the land use objectives embodied in the New Jersey State Development and Redevelopment Plan. Some of these criteria tend to be relatively compatible with each other, while others have a natural tension. For example, the goal of maximizing local autonomy is at odds with the goal of achieving greater equity in education funding and outcomes.

Clearly, no proposal can meet all goals equally well, and the function of the political process is to weigh the trade-offs to reflect public priorities. To do this well, both citizens and the public officials who represent them need the best possible information on what those trade-offs actually represent – in dollars and cents, in who will be most affected, and in how they are likely to shape the physical, social and economic landscape of New Jersey. Measuring these impacts is limited by imperfect data and the complicated process of sorting out how the behavior of homeowners, developers, municipal officials and others would change under different assumptions. However, both quantitative measures and reasoned judgments can help to piece together a picture of how the state would change under different proposals.

This report uses a combination of economic theory and available property tax, Census and land-use data to evaluate how well five hypothetical property tax reforms would affect each of the seven

criteria. The same methodology could be used to assess any number of proposals. While far from definitive, these evaluation tools are a means for making apples-to-apples comparisons of how different reforms would answer the following questions:

- How much would school property taxes and other taxes change?
- How would these changes be distributed across municipalities throughout the state?
- How would these reforms change the incentives for investing in housing and other types of development, for preserving open space, and for spending on education and other local services?

The following describes the specific indicators that were used to assess each criterion. They are organized into two categories: Land Use and Social Equity, and Efficiency and Fiscal Health. The first includes three policy objectives – consistency with State Plan goals, promotion of affordable housing and attainment of education equity – that have tangible outcomes such as land developed, number of housing units, and education spending per pupil. The second category includes four criteria – flexibility, fiscal discipline, fiscal stability and local autonomy – that are difficult to quantify but are nonetheless important policy goals. One criterion identified in the first report – economic efficiency – was eliminated as a separate goal. In examining how to measure this criterion, it became clear that it overlaps with several of the others. For example, consistency with the State Plan promotes economic efficiency by promoting the use of existing infrastructure and other resources. To some extent, local autonomy can also promote the efficient allocation of tax dollars by allowing people to choose among places with different bundles of services and costs. Far from de-emphasizing the importance of economic efficiency and growth, this underscores the centrality of these objectives. In the long run, states that make efficient use of land and tax dollars, provide an adequate supply of housing and have fiscal policies that can adapt to changing economic conditions will experience stronger economic growth. However, the criteria may not fully capture short-run impacts on economic growth, such as the effect of a changing mix of taxes on competition with other states.

In evaluating the criteria, it is assumed that the outcomes are determined by three policy levers that are primarily under local control – zoning, tax rates and services. Because the proposals are revenue neutral, it is assumed that each would provide the same level of service as the status quo. Tax rates can change considerably under these proposals and are quantified to the extent possible. It is assumed that, all other things being equal, development will be attracted to places with the lowest tax rates. Finally, zoning and other land-use regulations are likely to be affected by the changes the proposals make to incentives for localities. These incentives are evaluated by examining the internal logic of the proposal and established theory on how these types of policies are likely to change behavior.

Land Use and Social Equity

1. Consistency with State Plan goals is a clear objective that is not necessarily easy to measure. With the State Development and Redevelopment Plan, New Jersey has a very specific map for testing how well property tax reforms would improve land use. As the title of this criterion implies, it captures the degree to which policies encourage growth in urban areas, suburban centers and other areas designated by the State Plan for growth, and discourage growth in areas designated as environmentally sensitive and agricultural. However, judging the impacts of tax reforms requires analysis of how they would change

both incentives and actual development behavior. In this report, two benchmarks are used to evaluate these impacts:

- Policies that increase incentives for redevelopment and decrease incentives for greenfield development, both among and within municipalities, were ranked highly for this criterion.
- Proposals also rank high for this criterion if tax rates decline in municipalities that are primarily urban or suburban, both overall and in relation to rates in places that are primarily rural or undeveloped. Since many places cannot be cleanly defined in this way, it is not a definitive measure of how incentives would change.

2. Consistency with affordable housing goals measures the extent to which policies create incentives or remove barriers to build housing statewide for low, moderate and middle-income households. There are no definitive benchmarks for measuring this criterion, but there are several indicators that can be used to infer which policies would result in the construction of more affordable housing units:

- Policies which minimize taxes on new development, while not favoring any particular type or price of housing, are ranked highly because they are expected to produce more housing at all income levels.
- Reforms that reduce tax rates in higher-density locations, which are more often near transit and downtowns, are more likely to result in multi-family housing that would include units at different price ranges, and are therefore ranked highly.

3. Education equity measures the extent to which revenues are increased, or tax rates are reduced with no change in revenues, in Abbott districts and other low-income municipalities. This does not address adequacy or equity in spending, much less predict education outcomes. But it does measure the degree to which school property tax reform reduces disparities in the revenue capacity of high-income and low-income municipalities. It also reduces fiscal stress on low-income districts and makes it more likely that they will attract mixed-income residents, both of which could help improve education outcomes. The benchmarks used for this criterion are straightforward comparisons of how rates and revenues change for municipalities at different income levels:

- Reforms that reduce rates or increase revenues in Abbott districts, relative to non-Abbott districts, rank higher for education equity.
- Similarly, reforms that reduce rates or increase revenues for other low-income districts also rank higher.

Efficiency and Fiscal Health

4. Flexibility measures how well a tax works across different types of places and economic environments. For example, a tax that gets most of its revenue from new growth (e.g., tax increment financing) will work well in places that are growing rapidly but not in places that are declining, while one that uses existing sources of revenue to subsidize additional growth (e.g., economic development incentives) can be inefficient and inequitable in places that are already growing. To get a rough approximation of how well reform proposals meet this criterion, two benchmarks are used:

- Reforms that allow tax rates to be adjusted to adapt to different circumstances are judged to be more flexible than those that do not.
- Proposals that bias tax rates in a counterproductive direction—higher in declining or stagnant municipalities and lower in growing places—are judged to be less flexible.

5. Fiscal discipline measures how well a reform improves incentives for local governments to operate efficiently and hold down the costs that lead to higher property taxes. Since local school taxes are linked to budgets that require voter approval, there is currently a strong incentive to hold down costs. However, this incentive varies considerably depending on factors such as the mix of commercial and residential property, the amount and form of state aid, and spending mandated by the state and federal governments. Incentives could be strengthened either by creating a stronger link between the responsibility for taxing and spending, by state caps on revenue or spending, or by linking state aid to efficiency measures. While it is difficult to generate quantitative benchmarks, the proposals can be qualitatively assessed for how they affect this criterion:

- Proposals are ranked more highly to the degree that they either align local tax burdens with local spending authority or create stronger incentives for operational efficiencies through state aid programs and formulas.

6. Fiscal stability measures the extent to which different proposals would provide a stable source of revenue through economic cycles, and allows rates to be adjusted to meet changing needs. Since revenues from property taxes are relatively stable compared to income, sales and some other taxes, proposals that replace property taxes with other sources of revenues can be expected to perform poorly by this criterion. To measure fiscal stability, the following benchmark is evaluated:

- Proposals that shift the tax burden to less stable sources of revenue are ranked less highly.

7. Local autonomy reflects the long-held value for municipalities to control their own fiscal, service and land-use authority to the greatest extent possible. Reforms will only affect local autonomy to the degree that they restrict municipal powers to raise revenue or determine spending. Measuring this criterion is less about quantifying impacts than it is about examining the structure of the proposal. Therefore, proposals are evaluated according to the following guideline:

- Proposals are ranked highly to the degree that they preserve municipal authority over taxing and spending. In particular, authority over spending is the key variable for proposals that are revenue-neutral for the state as a whole.

Methodology for Selecting and Analyzing Reform Proposals

In the debate around property taxes in New Jersey there is usually at least one issue where everyone agrees: property taxes should be lower. Lowering property taxes necessarily requires taking a look at what services they fund and what alternatives are available for delivering these services, either through greater efficiencies or different sources of revenue. This question inevitably revolves around how to fund public elementary and secondary education. The total bill for local school property taxes in all municipalities in 2004 was \$10.183 billion, representing 55% of all property taxes. That number can only be lowered by (1) decreasing expenditures at the school district level and passing on the savings, or (2) decreasing local school property tax rates and finding a new revenue source to replace those funds.

The reform proposals analyzed in this report focus on school taxes, in part because they represent the majority of property tax spending and in part because the trade-offs can be more clearly delineated by zeroing in on this single purpose. However, each proposal could also be applied to other municipal or county taxes. The effects on non-school taxes are likely to be similar but not identical to those of school taxes. General municipal and county tax rates are likely to vary differently from school taxes, and thus could end up with different rankings for the criteria used than those given for school taxes.

This report examines five school property tax reform proposals:

Proposal 1

Vary the school property tax by state planning areas.

Proposal 2

Collect all school property taxes at one statewide rate.

Proposal 3:

Collect all school property taxes at a county rate, and consolidate school districts at the county level.

Proposal 4:

Substitute half the school property tax with an income tax surcharge.

Proposal 5:

Split the school property tax rate into a higher land tax and a lower tax on buildings and improvements.

There are many other options the state may choose, and many variations of each of these five proposals. These five were chosen to capture a range of revenue-neutral proposals and differentiate between the two ways in which property taxes affect land use, equity and other considerations. The distinction is between those effects 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 due to the incentives they create for municipalities to maximize their tax base and limit anything that adds to costs.

Of these five proposals, one would shift taxation dramatically from property to income. Another would still collect the same amount of school property taxes but eliminate the effect of local fragmentation by collecting revenue at one uniform rate across the state. A third would enact a form of regional taxation, and thus mitigate the effect of local fragmentation, through county-wide school taxes. The proposal to vary taxes by State Planning Areas would go even further by systematically reducing rates in areas where growth is favored by the State Plan. The remaining proposal would shift each household's burden away from the value of buildings and other built improvements and toward land value.

These five scenarios were specifically designed to be revenue-neutral. Changes to expenditures can be included as part of any property tax reform proposal, and spending should be analyzed as a separate issue. This report instead develops scenarios that change the basic structure of how local school property taxes are collected in the state. With spending separated out, it is possible to compare the effect of these proposals on various categories of municipalities and residents.

While these proposals can demonstrate a wide variety of the impacts that property tax reform may have on the state and localities, some important issues are out of the scope of this analysis. These include how each proposal compares with the current package of property tax rebates and refunds available, and whether and how the proposals would change the existing rebate package. This is addressed to some extent in the analysis of the income tax substitution proposal, but it is not addressed in the others. In reality, there would likely be an overhaul of the rebate package and state aid in addition to reform. Savings

from eliminating some of the rebates might be used to make up funding gaps in a new system, while other rebates (for example for seniors and veterans) might be unchanged.

Also out of this report's scope are variations on each proposal. For example, instead of the specific scenarios described in this report, the state could enact a statewide or countywide property tax rate to fund part (not all) of the school costs, or an income tax surcharge that would substitute for more or less than the 50% of the school property tax levy suggested in this scenario, or the state could undertake a complete switch to a land tax instead of having land taxes fund 75% of school needs as suggested in this report's scenario. Exclusion of these issues and options only indicates the limited scope of this analysis and does not reflect their importance to finding a lasting solution for the state.

One of the primary analytic tools used measures changes in property taxes for each municipality for each of the five proposals and then analyzes how these changes were distributed among municipalities categorized by several indicators—size, density, growth, wealth, income, State Plan classification and Abbott designation. Each of these is associated with one or more criteria, and provides an indication of how tax burdens, spending and land use

would be likely to shift with a change in tax laws. Because of data limitations and the nature of the criteria, this method is more useful for judging some criteria and some reform proposals than others. Also, some outcomes, such as changes in zoning and land use regulations, are not captured by this method. Therefore, the evaluations also include other measures and qualitative judgments based on established theory. Much of the theoretical and empirical work on this topic is discussed by Coleman and Gottlieb in the first report in this series.

Definitions of Categories

Many of the tables in this analysis use categories of population growth, density and urbanization. For simplicity, shorthand is used in the text. These are the definitions of these categories.

Population Growth

Tables 3, 7, 12, 18 & 22

Population growth is considered from 1990 to 2004, as reported by the US Census, and is categorized as follows:

Declining or stagnating population = population declined or didn't change

Slowly growing = just over 0 to 7% growth

Moderately growing = just over 7% to 18% growth

Quickly growing = Over 18% growth in population

Population Density

Tables 1, 5, 10, 16 & 19

Population density data is from the US Census in 2004, and is categorized as follows:

Very low density = less than 1,000 people per square mile

Low density = 1,000 to 5,000 people per square mile

Medium density = 5,001 to 10,000 people per square mile

High density = 10,001 to 20,000 people per square mile

Very high density = more than 20,000 people per square mile

Urbanization

Tables 1-4, 9, 15 & 20

To quantify each proposal's consistency with the State Plan, municipalities were divided into three categories, using data from the state showing the number of acres each municipality has in each State Plan planning area:

Urban and suburban = those 283 municipalities where more than 75% of the land is categorized by the State Plan under planning areas 1 and 2

Rural = rural and environmentally sensitive, or those 197 municipalities where more than 75% of the acres are planning areas 3 and higher

Mixed = the remaining 86 municipalities that cannot be categorized as primarily urban or rural

Tax Rates

Throughout the report, tax rates are shown as dollar amounts per \$100 of *equalized* assessed value.

Technical Note

Tables 4-7 & 9-12

While there were 566 municipalities in 2004, two of them are not counted in parts of the analysis because they had \$0 school property taxes: Lower Alloways Creek Township in Salem County (population 1,900) and Pine Valley Borough in Camden County (population 22). These two municipalities were excluded from parts of the statewide tax and countywide tax analysis since they do not have a school property tax rate, and that fact would not change under these scenarios.

Proposal One

Vary the School Property Tax by State Planning Areas

This proposal would explicitly tie property tax reform to implementation of the New Jersey State Development and Redevelopment Plan, a goal that has been articulated by a number of commissions, legislators and policy experts over the last two decades. For example, the State and Local Expenditure and Revenue Policy (SLERP) Commission issued a report in 1988 that anticipated the first State Plan and recommended a statewide system of differential taxes on new construction to support the land use objectives of the forthcoming Plan. The report also recommended reducing property taxes by increasing income and sales taxes, instituting a circuit breaker that stops any person from paying too much in combined taxes, consolidating services on a variety of regional levels to lower overall expenditures, and many other proposals. Ten years after the SLERP report, a property tax commission convened by Governor Whitman made some of the same recommendations, including calling for supporting the State Plan's use by municipalities, counties and state agencies as a means of holding down property taxes.

The appeal of this idea, which would decrease taxes in places where the State Plan would encourage

growth relative to areas where it would discourage growth, is that it would simultaneously address two related policy objectives of "smart growth" advocates. In theory, it should back up the goals of the State Plan with financial incentives for its implementation, and lessen the incentives for fiscal zoning that causes school districts and municipalities to seek tax-generating development while shunning most types of residential development.

There are a number of different ways that this concept could be implemented. The SLERP Commission recommended a tier-graduated tax that applied to new structures only, and that had a sunset provision for specific structures. The logic was that there was no need to provide development incentives or disincentives to structures that had already been built, and this limited change would cause only minimum disruption to the existing system. Other approaches could have differential rates for existing and new properties but limit it to certain types, such as commercial. It could be implemented by decreasing rates in some areas and increasing them in others, or it could be implemented without any rate increases by using state revenues to reimburse districts with decreased rates.

The scenario described in this report uses a simple two-tiered rate structure on all property. While this may not be the ideal approach, it is the clearest way to demonstrate the advantages and disadvantages. This could be done in a revenue-neutral fashion by decreasing school property taxes in planning areas 1 and 2 (suburban and metropolitan areas) by the same total amount as school property taxes are increased in planning areas 3 and higher (fringe, rural, and environmentally sensitive areas). Under this proposal, the state would collect school property taxes from all localities and refund municipalities the same amount that they currently spend. The burden of paying for schools would not shift away from property taxes per se, but rather shift from property taxes in places where growth is encouraged to places where growth is discouraged. This approach would require the state to adjust rates and reimbursement annually and take into account the changing needs of each district. Thus, it would ideally be combined with a comprehensive reform of education spending across school districts. A less sweeping approach could limit the state's role to setting a uniform rate reduction in areas designated for growth and reimbursing these areas with either state revenues or a corresponding rate increase on property taxes in planning areas 3 and higher. School districts would still be responsible for setting their own budgets and rates, but would take into account the rebate or surcharge determined by the state.

Because municipalities and school districts often contain multiple planning areas, it is not always possible to characterize which municipalities would benefit most. Some single properties, in fact, encompass more than one planning area.² Therefore it is not possible to analyze the overall quantitative outcomes of this proposal, such as how much property tax rates might change in each municipality.

To attempt to understand what some quantitative outcomes might be, municipalities were divided into three categories - urban & suburban, rural, and mixed (areas that cannot be categorized as primarily urban or rural) - as described in the methodology section. The following discussion describes how each of these groupings would be affected and what the implications would be for the seven previously-described criteria.

Share of Municipalities categorized by State Planning Area ...

Urbanization Category	Table 1 ...by Population Density Category						Table 2 ...by Abbott Status		Table 3 ...by Population Growth Category					Total Mun.
	Very Low Density	Low Density	Medium Density	High Density	Very High Density	Total	Non-Abbott Districts	Abbott Districts	Declining or stagnant population	Slowly Growing	Moderately Growing	Quickly Growing	Total	
Mixed	31%	62%	6%	1%	0%	100%	16%	10%	7%	24%	23%	45%	100%	86
Urban & Suburban	4%	59%	25%	10%	3%	100%	48%	84%	23%	31%	30%	15%	100%	283
Rural	75%	25%	1%	0%	0%	100%	36%	6%	22%	17%	24%	37%	100%	197
Total	33%	48%	13%	5%	1%	100%	100%	100%	20%	25%	27%	27%	100%	566
Municipalities	184	270	76	28	8	566	535	31	116	144	152	154	566	

Land Use and Social Equity

Consistency with State Plan goals

High

This proposal is designed to implement State Plan principles, making local taxes vary according to state planning designations. As such, there is a nearly perfect alignment between the goals of the plan and the incentives built into this proposal. The magnitude of the effect would depend on how widely the rates are made to vary.

Consistency with affordable housing goals

Moderate

The net effects on total housing production are difficult to determine, because housing would be more expensive to build in some locations and less expensive in others. However, there would be a greater likelihood of building multi-family housing that would serve a wider range of income levels and family types. Table 1 shows that most of the densest municipalities can be categorized as urban while most of the sparsely populated municipalities are considered rural. Following that, this proposal would decrease property taxes in the most in dense areas, which are more likely to be appropriate for multi-family housing. This should spur an increase in housing supply in these areas, especially the supply of smaller units, and help to balance housing prices statewide and increase overall affordability.

Education equity

High

Since most students and residents live in planning areas 1 and 2, this proposal would lower their reliance on local property taxes for school funding. Also, as in Table 2, at least 26 of the 31 Abbott districts are in primarily urban areas that would benefit from lower school property taxes. Although this by itself does not guarantee that the distribution of education spending will change, it reduces fiscal stress and increases the ability to attract new residents and wealth in poorer districts, both of which could positively affect education spending and outcomes. The larger state role in school financing also increases the likelihood of more comprehensive measures to reduce education funding disparities.

² This scenario assumes that a formula would be established to set rates for properties in more than one planning area.

Efficiency and Fiscal Health

Flexibility

High

By adjusting rates to lean towards areas that have traditionally exhibited slow growth, this tool differentiates between places with differing economic environments. Table 3 shows that most of the quickly growing areas are made up of primarily planning areas 3 and higher. Under this proposal, these fringe suburbs and rural areas would have relatively higher local school property taxes than those areas that are more urban and growing more slowly. Also, since rates would need to be adjusted annually, there is an opportunity to calibrate them to changing economic circumstances.

Fiscal discipline

Moderate

The overall impact on fiscal discipline will depend on how revenues are reallocated to municipalities. Initially, a reallocation at current spending levels would have little effect. Over time, however, the state will need to determine how much taxes will rise and how they will be allocated. Simple formulas based on past spending and changes in the number of students would have little impact on current spending restraints. Formulas that left school districts with the primary responsibility for determining service costs would loosen cost constraints under this system, while those that set spending limits or provide incentives for specific efficiency measures could reduce costs.

Fiscal stability

Moderate

On average, there would be little change in the sensitivity of municipal fiscal conditions to changes in economic conditions if this proposal were implemented. Local revenues will still be drawn primarily from property taxes which tend to be a relatively stable revenue source. There might be some slight effect on particular municipalities because of how the state adjusts rates from year to year, but no statewide impact.

Local autonomy

Low

While the amount and use of expenditures would not theoretically change under this proposal, the ability of municipalities to set their own property tax rates would be compromised. Also, there would be a greater likelihood for a stronger state role in determining local education spending levels if they are playing a larger role in determining revenue sources.

Summary

Overall, varying taxes by state planning areas would tend to strongly support land-use and social-equity goals and have mixed results for efficiency and fiscal health. The precise impacts would depend to a large degree on how the proposal is structured, how much rates vary, and how the state redistributes revenues. Clearly, the proposal would raise issues of fairness and generate opposition from places that would see rates increased. To some degree, this opposition could be reduced with more limited proposals, such as ones that only vary rates for new construction, or ones that combine variations in rates with across-the-board reductions in property taxes.

Proposal Two

Collect All School Property Taxes at One Statewide Rate

Variations on a statewide property tax have been implemented with varying degrees of success in achieving fiscal discipline and education equity. Some states, such as New Hampshire and Massachusetts, fund education with a statewide property tax in addition to local property taxes. Others exercise state-level control over local property taxes.³

A statewide tax rate is generally intended to meet two objectives—to make taxes more equitable among property-rich and property-poor municipalities, and to remove the incentives that cause the ‘ratables chase’. In theory, by making all school districts’ tax

rates identical, districts with low property values would not have to set higher rates to provide for education expenses. And since the state would be collecting the revenue and redistributing it to the districts, municipalities would not be inclined to court only low-cost, high tax revenue development - such as commercial and retail development - while eschewing multi-family housing or other residential development that leads to higher costs and forces towns to increase tax rates. As a hypothetical example, if no town in New Jersey gained a single net taxpayer and only one town had increased school costs, the whole state would have a miniscule increase in tax rates to cover that increased cost. The incentives that now force mayors to favor strip malls over housing and parks would theoretically be largely removed.

A statewide property tax could take a variety of forms, such as the state collecting some share of local school property taxes and redistributing those resources, the state applying its own rate to some share of local property, or other varieties. For this report, the simplest scenario was chosen: all property in the state would be subject to the same school property tax rate, and the state would refund municipalities so that they receive the same amount for schools as they do now. The revenue-neutral, statewide school property tax rate would be \$1.083. If this rate were applied to all property, the state would collect \$10.183 billion, the same amount now collected from all municipalities’ school property taxes.

Under this proposal, some municipalities would experience an increase in school property taxes while others would experience a decrease. In total, there would be 5.1 million residents whose households would experience a decrease in property taxes and 3.6 million residents who would see an increase.

As with the proposal to vary taxes by State Plan area, the method for redistributing taxes to school districts after the initial year would have a substantial impact on criteria such as education equity and local autonomy. The analysis below shows the impact for the initial year and assumes that the rate used in future years would be determined by the state, either using a formula pegged to the initial year or by some standard of educational need.

Affect of Statewide Tax Rate on Municipalities...		Table 4 ...by Planning Area Category				Table 5 ...by Population Density Category						Table 6 ...by Abbott Status			Table 7 ...by Population Growth Category					Total Mun.
		Mixed	Urban & Suburban	Rural	Total	Very Low	Low	Med.	High	Very High	Total	Non-Abbott Districts	Abbott Districts	Total	Declining or Stagnant Population	Slowly Growing	Moderately Growing	Quickly Growing	Total	
% change in equalized school property tax rate due to statewide rate	-25% or more	10%	51%	39%	100%	32%	53%	13%	3%	0%	100%	99%	1%	100%	36%	20%	20%	24%	100%	148
	-10% to -24.9%	20%	39%	41%	100%	42%	44%	15%	0%	0%	100%	100%	0%	100%	11%	27%	27%	34%	100%	154
	0% to -9.9%	16%	57%	27%	100%	31%	47%	11%	11%	0%	100%	98%	2%	100%	13%	27%	29%	31%	100%	62
	+ up to 10%	10%	56%	34%	100%	36%	46%	14%	4%	0%	100%	96%	4%	100%	18%	22%	32%	28%	100%	50
	+10.1% to +25%	12%	71%	18%	100%	24%	41%	21%	12%	3%	100%	79%	21%	100%	15%	27%	35%	24%	100%	34
	More than 25%	18%	52%	30%	100%	23%	50%	11%	10%	6%	100%	84%	16%	100%	21%	28%	30%	21%	100%	116
	Total	15%	50%	35%	100%	32%	48%	14%	5%	1%	100%	95%	6%	100%	21%	25%	27%	27%	100%	564
Municipalities	86	283	195	564	183	269	76	28	8	564	533	31	564	116	142	152	154	564		

Land Use and Social Equity

Consistency with State Plan goals

Moderate

Of the 195 municipalities identified as primarily rural, most (137) would experience a decrease in property taxes. Of the 283 urban and suburban municipalities, a slightly lower share (171) would experience a decrease in property taxes. In total, municipalities in mostly rural planning areas would be net contributors to the state, with an increase in school property taxes amounting to about \$154 million, while urban and suburban municipalities would experience a net decrease in school property taxes of about \$73 million. The difference would be made up by the 86 municipalities that could not be categorized by planning area. Another way to examine the land use impacts is to look at the number of acres in urban and rural areas and determine the changes in taxes. As with the rest of the land use analysis, the results are unclear. More acres of both rural and urban municipalities would have lower school property taxes than under the status quo system, but the differences are minor and made up by those places that cannot be categorized as rural or urban. Those municipalities represent nearly half the acres in the state. While property tax rates could change considerably in individual municipalities, this would not necessarily change the pattern of overall taxes by state planning area. This suggests that there would be limited change in the incentives that uniform tax rates would have on developers. However, the fiscal incentives for towns to use zoning to chase or shun development would be greatly reduced. This would likely lead towns to give greater priority to goals articulated in the State Plan, including protecting open space and attracting commercial and residential development to urban centers.

Consistency with affordable housing goals

Moderate

The affect on affordable housing is unclear. Overall housing production would likely increase, since municipalities would have less incentive to use restrictive zoning to keep out residential development that would increase school costs. However, this proposal would lower tax rates in many lower-density municipalities and increase it in areas that are most likely to build multi-family housing (see Table 5). Notably, 25 of the 36 densest municipalities would experience a school property tax increase, including the 8 densest municipalities in the state: Guttenberg, Union City, West New York, Hoboken, and East Newark in Hudson County; Cliffside Park Borough in Bergen; Passaic City; and Irvington Township in Essex. Property tax increases in these dense areas would damage the prospect for multi-family housing in the state overall, thereby working against state affordable housing policies.

Education equity

Low

In addition to raising rates for the densest municipalities, this proposal would raise rates for the poorest. To elucidate the effect, the wealthiest and poorest municipalities are identified. Of the poorest 103 municipalities – that is, those municipalities with a median household income of more than 20% lower than the state median – 45 would experience a decrease in school property taxes due to a switch to the statewide rate, while the remaining 59 poor municipalities, representing just under 2 million residents, would experience an increase. On the other end of the spectrum, of the 107 municipalities with a median household income of 50% or more higher than the statewide median, 56 would experience a decrease in school property taxes and the remaining 51 would experience an increase. This indicates that increased property taxes would disproportionately affect poorer areas, while decreased property taxes would benefit wealthier areas. The net effect paints a clearer picture: while the effect on each municipality may differ, the poorest municipalities as a whole would contribute \$355 million more per year in school property taxes while the wealthiest municipalities would contribute only \$40 million more per year. This is due in large part to decreases in some of the wealthier areas and increases in many of the poorest. Consistently, of the 31 Abbott districts, 29 would experience an increase in property tax rates.

Efficiency and Fiscal Health

Flexibility

Low

With a single uniform rate, there is no opportunity to calibrate tax rates for places with varying economic environments. It does not appear that this proposal would bias rates toward either growing or declining municipalities. Table 7 shows that there is no discernible pattern between rate of growth and whether the statewide rate causes an increase or decrease to the municipal rate.

Fiscal discipline

Moderate

As with the proposal to vary taxes by State Plan area, the overall impact of a statewide property tax on fiscal discipline will depend on how revenues are reallocated to municipalities. Initially, a reallocation at current spending levels would have little effect. Over time, however, the state will need to determine how much taxes will rise and how they will be allocated. Simple formulas based on past spending and changes in the number of students would have little impact on current spending restraints. Formulas that left school districts with the primary responsibility for determining service costs would loosen cost constraints under this system, while those that set spending limits or provided incentives for specific efficiency measures could reduce costs.

Fiscal stability

Moderate

Since there would be no statewide shift from property taxes to less stable revenue sources, there should be little impact on overall fiscal stability. Municipal revenues would still come primarily from taxes on property. Only the entity establishing the rates and collecting the taxes would change.

Local autonomy

Low

As with the proposal to vary rates by State Plan area, the ability of municipalities to set their own school property tax rates would be compromised. Also, there would be a greater likelihood for a stronger state role in determining local education spending levels if they are playing a larger role in determining revenue sources.

Summary

This proposal ranks either moderate or low for all seven criteria. Its main attribute is its effect in reducing the incentives for local fiscal zoning, but its actual impact on tax rates is either negligible or harmful to most criteria. However, the analysis is skewed by the fact that state education grants, spurred by Abbott and other court decisions, have already reduced many of the disparities that this tax might address. In effect, general state revenues are doing much of what a statewide school property tax could do. A statewide school property tax rate might still have merit, but only in the context of a comprehensive reform of all sources of education revenue, including state grants.

³ One example is California's Proposition 13 which caps local property taxes. Another is Minnesota where the general education levy is in essence a state property tax: the state sets the rate, and taxpayers would pay the same amounts regardless of whether the property tax revenues were paid directly to the school districts or the state general fund. January 24, 1997 "Money Matters, A Publication of the Minnesota House Fiscal Analysis Department on Government Finance Issues." Vol 12 No 3.

Proposal Three

Collect All School Property Taxes at a County Rate, and Consolidate School Districts at the County Level

This proposal combines two distinct elements. One is to replace local school property taxes with a county property tax, and the second is to consolidate all 611 school districts into 21 county-level school districts. Table 8 shows what the countywide tax rates would need to be to collect the same revenue in school property taxes in 2004.

Like a statewide tax rate, a countywide rate is intended to remove the incentives that cause the 'ratable chase'. While counties may still compete among themselves, the towns within each county would not be inclined to limit development or only promote low-cost, high-tax revenue development, because their increased costs would not directly require increased tax revenue. A countywide rate is akin to a simple form of regional tax sharing. The school property tax rate for the county would apply to all municipalities in that county. Counties would

essentially set a rate that would allow them to support each municipality's school budget. Tax base sharing can also occur at other levels of government, such as clusters of municipalities or places within a metropolitan region. The most famous example is the Minneapolis-St. Paul Twin Cities tax sharing district, a seven-county area where each of 187 towns contributes 40% of the growth in its commercial-industrial tax base to a regional pool. Funds from the pool are allocated to local governments according to a formula accounting for population and property value per capita. In the scenario examined for this report, the county functions as that 'regional pool,' and the county school property tax rate determines each town's contribution.

The second element of the proposal, to consolidate into 21 county-level school districts, has been proposed and promoted by many, notably by Senator Bob Smith, as a way to lower school expenditures and thereby lower property taxes.⁴ This element is included here to demonstrate an important concept that is often discussed when this subject is broached in New Jersey, that of regional consolidation of services. Ernest Roeck of the Rutgers Center for Government Services has also examined school consolidation and school district creation in New Jersey.⁵ His analysis finds that past school district consolidation has led to per pupil expenditure decreases. He estimates that consolidating all 611 school districts into 265 all-purpose K-12 school districts would result in annual statewide savings of 8.3% of total expenditures per pupil, or about \$300 million per year with additional initial administrative savings. However, for the sake of consistency with other proposals examined in this report, this proposal is assumed to be revenue neutral. That is, while school districts are consolidated, it is assumed for this analysis that school expenditures remain the same as they are now.

The tax rates for each county in this scenario are shown in Table 8. These rates would replace the separate school property tax rates now paid at the municipal level. Under this proposal, 323 municipalities (about 55% of the population) would experience a decrease in school property taxes, while the remaining 243 would experience an increase.

Table 8

County-Wide School Property Tax Rate Necessary to Support a Revenue Neutral Scenario

Atlantic	\$0.959
Bergen	\$1.053
Burlington	\$1.527
Camden	\$1.649
Cape May	\$0.339
Cumberland	\$0.965
Essex	\$1.082
Gloucester	\$1.506
Hudson	\$0.779
Hunterdon	\$1.371
Mercer	\$1.263
Middlesex	\$1.286
Monmouth	\$1.049
Morris	\$1.083
Ocean	\$0.748
Passaic	\$1.077
Salem	\$1.375
Somerset	\$1.105
Sussex	\$1.391
Union	\$1.071
Warren	\$1.217

Affect of Countywide Tax Rate on Municipalities...		Table 9 ...by Planning Area Category				Table 10 ...by Population Density Category						Table 11 ...by Abbott Status			Table 12 ...by Growth Category					Total Mun.
		Mixed	Urban & Suburban	Rural	Total	Very Low	Low	Med.	High	Very High	Total	Non-Abbott Districts	Abbott Districts	Total	Declining or Stagnant Population	Slowly Growing	Moderately Growing	Quickly Growing	Total	
% change in equalized school property tax rate due to countywide rate	-25% or more	10%	51%	39%	100%	32%	53%	13%	3%	0%	100%	99%	1%	100%	36%	20%	20%	24%	100%	148
	-10% to -24.9%	20%	39%	41%	100%	42%	44%	15%	0%	0%	100%	100%	0%	100%	11%	27%	27%	34%	100%	154
	0% to -9.9%	16%	57%	27%	100%	31%	47%	11%	11%	0%	100%	98%	2%	100%	13%	27%	29%	31%	100%	62
	+ up to 10%	10%	56%	34%	100%	36%	46%	14%	4%	0%	100%	96%	4%	100%	18%	22%	32%	28%	100%	50
	+10.1% to +25%	12%	71%	18%	100%	24%	41%	21%	12%	3%	100%	79%	21%	100%	15%	27%	35%	24%	100%	34
	More than 25%	18%	52%	30%	100%	23%	50%	11%	10%	6%	100%	84%	16%	100%	21%	28%	30%	21%	100%	116
	Total	15%	50%	35%	100%	32%	48%	14%	5%	1%	100%	95%	6%	100%	21%	25%	27%	27%	100%	564
Municipalities		86	283	195	564	183	269	76	28	8	564	533	31	564	116	142	152	154	564	

Land Use and Social Equity

Consistency with State Plan goals

Moderate

This proposal would modestly decrease property rates in many rural, lower density and wealthier areas while modestly increasing them in many urban, higher density and poorer areas. About 48% of the 283 municipalities categorized for this report as urban would experience an increase in property taxes, for a net increase of \$114 million among those urban areas. About 42% of the rural municipalities would experience an increase in property taxes, however the total affect would be a net decrease in school property taxes of about \$40 million paid by those rural municipalities. While the overall magnitude of this effect may not be great since county rates would not vary consistently with state planning designations, the net affect would be modestly inconsistent with State Plan goals of encouraging growth in planning areas 1 and 2. This would be balanced to some degree by a reduced propensity for fiscal zoning, at least within the boundaries of the counties.

Consistency with affordable housing goals

Moderate

The results for this criteria are similar to the results found for a statewide property tax. While the decreased incentive for fiscal zoning could increase housing production, other changes would be slightly negative. A majority of the municipalities with more than 10,000 people per square mile would have rate increases, while a majority of lower density municipalities would have rate decreases. The differences are not very large, however, and the change in rate is fairly evenly spread among municipalities in all density categories, indicating a modest inconsistency with state affordable housing goals. Nonetheless, 22 of the 36 densest municipalities would experience an increased tax rate, including the 8 densest towns in New Jersey. This is a slightly more modest outcome than the statewide tax scenario, but still reveals a negative impact on the state's affordable housing goals.

Education equity

Low

Of the 103 poorest municipalities (defined on page 11), 52 would experience decreases in property taxes and the remaining 51 would experience increases. The net result would be an increase of \$105 million paid in property taxes for these 103 poorest towns. Of the 107 wealthiest municipalities, 49 would experience decreases in property taxes and 58 would experience increases. The net result would be an increase of \$110 million paid in property taxes for these 107 wealthiest towns. The remaining 356 municipalities that fall into neither the poorest or wealthiest categories would experience a net decrease, so that the state collects the same amount in school property taxes as it does presently (just over \$10 billion). Overall, the switch to a countywide school property tax would not disproportionately affect the poorest or wealthiest communities. However, like the statewide tax, this proposal would result in a property tax rate increase for nearly all of the Abbott Districts. While four districts would experience a lower tax, 27 would have a tax increase.

⁴ Senator Bob Smith, "Another Way to Reduce Property Taxes." http://www.senatorbobsmith.org/files/5_2005-02-16_School_District_Consolidation.pdf.

⁵ "The Cost Impact of School District Creation and Consolidation in New Jersey, 1995 and 2003." (Roeck, 2003).

Efficiency and Fiscal Health

Flexibility

Moderate

A uniform countywide property tax would be somewhat more flexible than a statewide tax since it would allow for variations in different regions of the state that may experience different market and cyclical conditions. The proposal is not likely to bias rates strongly in either direction. Table 12 demonstrates that it is just as likely for a quickly growing municipality to have a higher or lower rate under the countywide plan as it is for a moderately or slowly growing municipality.

Fiscal discipline

High

Under this proposal, counties would set both the budgets and tax rates for schools throughout the county. They would have both the incentive to keep taxes low and ability to realize administrative efficiencies through shared services, elimination of duplicative services and economies of scale. While efficient service is by no means assured and depends on effective governance and management at the county level, the structure of this concept should create greater incentives for these types of productivity enhancements. The Roeck study cited above indicates that these savings could be substantial.

Fiscal stability

Moderate

As with statewide property taxes, there would be no shift to less stable taxes and little effect on the stability of local revenue at different points in the business cycle.

Local autonomy

Moderate

As with the two previous proposals that would move the power to set and collect tax rates to the state level, this proposal would compromise local autonomy by removing the ability of municipalities to set their own school property tax rates. It would also explicitly remove the local school district level of decision-making around spending, something that would be dependent on the redistribution method left unspecified in the first two proposals. However, county seats are much closer to municipalities and school districts than Trenton, resulting in this proposal having a more moderate impact on local autonomy.

Summary

Overall, this proposal performs modestly better than a statewide property tax. Its effects on fiscal zoning are more muted, but so are its negative impacts on local autonomy. It is also affected by the same redistribution that has already occurred from state grants to localities, and cannot be completely assessed without also considering comprehensive reform in education finance. Its high ranking in fiscal discipline results not from the reforms on the revenue side, but from its explicit attention to service delivery.

Proposal Four

Substitute Half the School Property Tax with an Income Tax Surcharge

The income tax substitution proposal would refund half of school property taxes with an increase to the income tax. The idea has been promoted by Assemblyman Louis Manzo, and was proposed in legislation known as the NJ SMART (New Jersey Save Money and Reform Taxes) Act, sponsored by Manzo, Assemblyman John McKeon, and Senator Joseph Doria in May 2005.⁶ Proponents of the proposal expect that it would decrease inequities by switching half the property tax burden to a more progressive tax, and would mitigate the ‘ratable chase’ because a town’s higher costs or need for more tax revenue would not necessarily be directly passed on to the residents.

Under this proposal, each resident’s school property tax would be reduced by half. Municipalities would be reimbursed by the state for the decrease in property tax revenue. The state would raise the revenue for these reimbursements with a statewide surcharge to the income tax. Presently, New Jersey income tax payers fall into six tax brackets, shown in Table 13. The surcharge would be a uniform percentage of each taxpayer’s adjusted gross income tax liability. In this way, each taxpayer’s income tax would increase by the same rate to raise the funds necessary to repay municipalities for their school property tax decreases. The rate would be determined annually, and it would be set to raise only enough revenue to pay for 50% of each residence’s school property taxes.⁷

Two groups of income tax payers would not be subject to the uniform rate: those earning \$30,000 or less would not pay the surcharge, and the surcharge for those earning \$500,000 or more would be based on income taxes as if they had been paid at 6.37%.

All residents’ school property taxes added up to \$10.183 billion in 2004. Assemblyman Manzo estimates, however, that NJ SMART would not apply to this entire amount, and would affect only the 2.89 million tenants and homeowners who are

full time residents. These residents pay \$6.457 billion in school property taxes per year. Under this proposal, these residents would be refunded by the state for half that amount, or \$3.228 billion.

The NJ SMART bill would mostly eliminate the major property tax mitigation program now administered by the state: the FAIR program formerly known as the Homestead Rebate and NJ SAVER programs. Under this proposal, residents over 65 would be eligible for the greater of either the NJ SMART plan (half their property taxes) or the FAIR rebate. Other property tax rebate programs, such as those protecting veterans and seniors, would be kept in place. General Fund savings from mostly eliminating the Homestead Rebate and NJ SAVER programs, and from reduced school property tax deductions, would help to offset the total income tax surcharge needed to refund municipalities for half their school property taxes.

For 2004, the income tax surcharge needed to refund half the property taxes to each municipality is estimated at 25.36%.⁸ For example, the homeowner who pays \$1,173 in income tax and \$3,000 in school property taxes would be refunded \$1,500 (half of the school property taxes) and would have to pay a surcharge of \$297 (25.36% of income taxes). That household’s net savings would be \$1,203. While it is not possible to determine exactly how many net winners and losers – or ‘recipients’ and ‘donors’ – would result from implementing this proposal, it is possible to make some generalizations based on the overall wealth and tax levy of municipalities.

This is the only reform proposal considered in this report that includes a net decrease to property taxes and a new revenue source. Which source to use can be debated. The proponents of this proposal assert that the income tax is the best source because it is based on a progressive structure; others may advocate for an extension of the sales and use tax to services, or other resources. In addition, the prospect of a new resource raises the issue of constitutional dedication, which is not addressed in this report. Constitutional dedication would require revenue collected from the new source, such as the income tax surcharge, to be used only for a given purpose, such as reimbursing municipalities for reduced property tax collections. Some argue that constitutional dedication is the only way to ensure revenues end up where they are intended, while others argue that it unduly restricts the state from managing its budget each year and does not allow enough flexibility to handle future fiscal needs. This debate would likely surface if any reform proposal were considered that requires a new revenue source to make up for a net decrease in property taxes.

Tables 14a and 14b show the general impact of the plan on 566 municipalities, categorized by median income and size of school property tax levy per household. The places in green have a low median income, and the blue ones have higher incomes. The amount collected from the income tax surcharge on the green municipalities would be relatively low, and on the blue would be relatively high. The amount the municipality receives back is dependent on the size of its school property tax levy, shown on the left. Those 5 municipalities in dark green, representing 8,000 households, would receive the most back in property taxes relative to the income tax surcharge paid by their residents. Those 39,000 households in the 10 municipalities shown in dark blue would have the highest increases to their income taxes while their municipalities would receive the least back to recoup school property tax revenue.

These are generalizations meant to reveal any patterns in the impact of the plan, and they are restricted by the lack of complete data. Taking the top left green box as an example, not all residents in those 9 municipalities earn under \$30,000, rather those municipalities have a median household income of \$0 to \$30,000. Some residents in those 9 towns would likely be considered ‘donors’ under this plan, because they have high incomes and the income tax surcharge would collect more from them than they had been paying in school property taxes. In addition, some of the residents in the far right column, earning \$110,001 and more, would have an income tax adjustment in their favor due to the revision to the half millionaire’s tax proposed in the NJ SMART bill. Nonetheless, Tables 14a and 14b show that residents in most of the towns with the largest increases in income taxes would also have the largest decreases in property taxes. In addition, the very extreme ‘donors’ and ‘recipients’ – those in dark green and dark blue – represent less than 1% of municipalities and 1.3% of households. This indicates that only a very small number of residents would be overly favored (by low income tax surcharges and high property tax refunds to their municipalities) or burdened (by high income tax surcharges and low property tax refunds to their municipalities) by this plan.

Land Use and Social Equity

Consistency with State Plan goals

Moderate

This proposal would not necessarily work for or against the State Plan. In most places, decreases in property taxes are likely to be roughly balanced with increases in income taxes and, as shown in Table 15, municipalities of both high and low median incomes and large and small school property tax levies are evenly distributed among State Plan areas. Incentives for fiscal zoning would be reduced, but far from eliminated, with the revenue needed from school property taxes cut in half.

Consistency with affordable housing goals

High

Affordable housing goals would be supported in two ways. Lower property taxes would lower the cost of owning a home or rental property and likely lead to more housing development. Also, dense places would be much more likely to be the largest beneficiaries of the plan while sparsely settled places would likely experience smaller property tax decreases and larger income tax increases (Table 16 shows the 'recipient' to 'donor' ratio increasing with population density). Assuming this leads to more multi-family, mixed-income housing, it would thereby reinforce the goals of the state's affordable housing policy. This proposal's proponents also claim that it would increase the housing purchasing power of residents simply by lowering their overall tax bill. This is likely to be true to some extent, although the largest property tax decreases are likely to go to those with the highest incomes.

Education equity

High

The proposal would address education equity in general by decreasing the reliance on local property taxes for school funding, and by obtaining a greater share of the sources of school funding from higher income households and a lower share from lower income households. Tables 14a-b show that the municipalities with higher tax levies tend to also have wealthier residents, indicating that, in addition to being socially equitable, this redistribution may be geographically fair: that is, the additional income tax surcharge burden is spread fairly evenly across places that experience a commensurate benefit from the property tax rebate. This proposal would not, however, address the gap between school spending in wealthy and poorer districts.

Table 13

NJ Income Tax Brackets 2006			
Single		Married filing jointly	
Income	Income Tax	Income	Income Tax
\$0 - \$20,000	1.40%	\$0 - \$20,000	1.40%
\$20,001 - \$35,000	1.75%	\$20,001 - \$50,000	1.75%
\$35,001 - \$40,000	3.50%	\$50,001 - \$70,000	2.45%
\$40,001 - \$75,000	5.53%	\$70,001 - \$80,000	3.50%
\$75,001 - \$500,000	6.37%	\$80,001 - \$150,000	5.53%
\$500,001 +	8.97%	\$150,001 - \$500,000	6.37%
		\$500,001 +	8.97%

Efficiency and Fiscal Health

Flexibility

Moderate

Since municipalities would have the same ability to set rates as they do now, this proposal would have minimal effect on the flexibility of the current system. This proposal would have more benefits for municipalities with declining populations than for those with growing populations, however the magnitude of the difference is not very large.

Fiscal discipline

Low

Localities would still largely determine the size and content of their school budgets, but would have half of their property taxes reimbursed by the state. This would create a disincentive to hold down costs, since half of any spending increase would be "free money" from the perspective of the school district. However, the state could compensate for this in various ways, such as by specifying limits on what could be reimbursed for certain types of costs.

Fiscal stability

Low

Since income tends to fall more quickly during recessions than property values, this proposal would introduce an additional element of instability into the state's revenues. Revenue shortfalls in down times would either have to be passed on to school districts and municipalities or worsen the state's fiscal condition during times when budget shortfalls are of most concern.

Local autonomy

High

Localities would still be able to set their own budgets and tax rates, so local autonomy would be preserved. Arguably, it would even be enhanced, at least in the short term, because school districts would have additional resources without any increases in spending mandates or fiscal responsibility. Over the long run, the tendency to lower constraints on local spending could induce the state to include more restrictions or incentives to hold down costs.

Summary

This proposal ranks relatively high on land use and social equity criteria, in large measure because it would remove half of the fiscal costs that localities incur to fund public education, and because the impacts are progressive in shifting the tax burden to wealthier taxpayers and towns. Performance on economic and fiscal criteria is mixed, with the largest issues being how it would affect local spending and the fiscal condition of the state.

⁶ NJ SMART is Assembly Bill No. A-1284 and Senate Bill No. S-187. Details of the bill can be found here: <http://reformschooltaxes.com/proposal.htm>.

⁷ This proposal assumes that all renters pay for school property taxes with 9% of their rent, a number developed by the state for other tax deduction purposes. In fact, property tax payments in rent are not uniform among municipalities. If this proposal were accepted, this feature may be kept for simplicity and consistency with the existing tax code, or it may be changed to better reflect actual tax payments in rent. If there were a change, the result would impact the hypothetical outcomes discussed in this report, potentially significantly: renters comprise 34% of households in New Jersey.

⁸ The amount of school property taxes to be refunded is actually based on prior year spending. For more examples, see www.reformschooltaxes.com.

Table 14a

		Municipality's Median Household Income, 2000								Total
		\$0 to \$30,000	\$30,001 to \$40,000	\$40,001 to \$50,000	\$50,001 to \$60,000	\$60,001 to \$70,000	\$70,001 to \$90,000	\$90,001 to \$110,000	\$110,001 and higher	
Half of School Property Tax Levy Per Household, aka Average Household Tax Refund	\$0 to \$1000	9	32	36	10	1	2	1		91
	\$1001 to \$1300		6	39	24	6				75
	\$1301 to \$1600	2		22	44	8	5			81
	\$1601 to \$1900		4	5	28	31	6		1	75
	\$1901 to \$2200		1	1	10	28	12	2		54
	\$2201 to \$2500			2	6	18	26	1		53
	\$2501 to \$3000	1	1	1	2	5	31	10	2	53
	\$3000 to \$3500				1	1	13	17	6	38
	\$3501 to \$5000			1	1		8	17	9	36
	over \$5000		2	2	1	1			4	10
Total		12	46	109	127	99	103	48	22	566

Table 14b

		Municipality's Median Household Income, 2000								Total
		\$0 to \$30,000	\$30,001 to \$40,000	\$40,001 to \$50,000	\$50,001 to \$60,000	\$60,001 to \$70,000	\$70,001 to \$90,000	\$90,001 to \$110,000	\$110,001 and higher	
Half of School Property Tax Levy Per Household, aka Average Household Tax Refund	\$0 to \$1000	10%	35%	40%	11%	1%	2%	1%	0%	100%
	\$1001 to \$1300	0%	8%	52%	32%	8%	0%	0%	0%	100%
	\$1301 to \$1600	3%	0%	27%	54%	10%	6%	0%	0%	100%
	\$1601 to \$1900	0%	5%	7%	37%	41%	8%	0%	1%	100%
	\$1901 to \$2200	0%	2%	2%	19%	52%	22%	4%	0%	100%
	\$2201 to \$2500	0%	0%	4%	11%	34%	49%	2%	0%	100%
	\$2501 to \$3000	2%	2%	2%	4%	9%	59%	19%	4%	100%
	\$3000 to \$3500	0%	0%	0%	3%	3%	34%	45%	16%	100%
	\$3501 to \$5000	0%	0%	3%	3%	0%	22%	47%	25%	100%
	More than \$5000	0%	20%	20%	10%	10%	0%	0%	40%	100%
Total		2%	8%	19%	22%	18%	18%	9%	4%	100%

Table 15

		Likely Outcome of Income Tax Substitution Plan. (See Table 14a)		
Effect of Income Tax Substitution Plan by State Planning Area Category		Municipalities which are likely to include residents who pay less through the surcharge than their municipalities receive back	Municipalities which are likely to include residents who will pay more through income tax surcharges than their municipalities will receive back	Green : Blue Ratio
State Planning Area Category	Mixed	20	66	0.3
	Urban & Suburban	92	191	0.5
	Rural	66	131	0.5
	Total	178	388	0.5

Table 16

		Likely Outcome of Income Tax Substitution Plan. (See Table 14a)		
Effect of Income Tax Substitution Plan by Population Density Category		Municipalities which are likely to include residents who pay less through the surcharge than their municipalities receive back	Municipalities which are likely to include residents who will pay more through income tax surcharges than their municipalities will receive back	Green : Blue Ratio
Population Density Category	Very low density	47	137	0.3
	Low density	70	200	0.4
	Medium density	31	45	0.7
	High density	23	5	4.6
	Very high density	7	1	7.0
	Total	178	388	0.5

Under the Income Tax Substitution Plan, which municipalities are likely to include residents who will pay more through income tax surcharges than their municipalities will receive back (**blue**) and which are likely to include residents who pay less through the surcharge than their municipalities receive back (**green**)?

Table 17a

		Municipality's Median Household Income, 2000								Total
		\$0 to \$30,000	\$30,001 to \$40,000	\$40,001 to \$50,000	\$50,001 to \$60,000	\$60,001 to \$70,000	\$70,001 to \$90,000	\$90,001 to \$110,000	\$110,001 and higher	
Half of Municipality's Local School Property Taxes, or the amount that would be refunded under this plan	up to \$2 million	6	20	39	41	15	13	1	2	137
	2 to 4 million	3	7	24	19	19	13	4	4	93
	4 to 6 million		2	17	17	18	17	5	2	78
	6 to 8 million		3	8	12	7	12	7	4	53
	8 to 10 million		3	9	9	7	9	6	4	47
	10 to 20 million	1	7	9	20	15	18	15	2	87
	20 to 30 million		3	3	4	7	12	6	3	38
	30 to 50 million	2	1		5	8	8	4	1	29
	over 50 million					3	1			4
Total		12	46	109	127	99	103	48	22	566

Green Pop. 3,194,189	Blue Pop. 3,812,779
Dk. Green Pop. 1,279,100	Dk. Blue Pop. 59,366

Table 17a

School Property Tax Refund by Median Income		Municipality's Median Household Income, 2000								Total	Total
		\$0 to \$30,000	\$30,001 to \$40,000	\$40,001 to \$50,000	\$50,001 to \$60,000	\$60,001 to \$70,000	\$70,001 to \$90,000	\$90,001 to \$110,000	\$110,001 and higher		
Half of Municipality's Local School Property Taxes, or the amount that would be refunded under this plan	up to \$2 million	4%	15%	29%	30%	11%	10%	1%	2%	100%	137
	2 to 4 million	3%	8%	26%	20%	20%	14%	4%	4%	100%	93
	4 to 6 million	0%	3%	22%	22%	23%	22%	6%	3%	100%	78
	6 to 8 million	0%	6%	15%	23%	13%	23%	13%	8%	100%	53
	8 to 10 million	0%	6%	19%	19%	15%	19%	13%	9%	100%	47
	10 to 20 million	1%	8%	10%	23%	17%	21%	17%	2%	100%	87
	20 to 30 million	0%	8%	8%	11%	18%	32%	16%	8%	100%	38
	30 to 50 million	7%	3%	0%	17%	28%	28%	14%	3%	100%	29
	over 50 million	0%	0%	0%	0%	75%	25%	0%	0%	100%	4
Total		12	46	109	127	99	103	48	22	566	

Table 18

Effect of Income Tax Substitution Plan by Population Growth Category		Likely Outcome of Income Tax Substitution Plan. (See Table 14a)		Green : Blue Donor Ratio
		Municipalities which are likely to include residents who pay less through the surcharge than their municipalities receive back	Municipalities which are likely to include residents who will pay more through income tax surcharges than their municipalities will receive back	
Population Growth, 1990 to 2004	Declining or stagnant population	63	53	1.2
	Slowly growing	37	107	0.3
	Moderately growing	46	106	0.4
	Quickly growing	32	122	0.3
	Total	178	388	0.5

Proposal Five

Split the School Property Tax Rate into a Higher Land Tax and a Lower Property Tax

Split rate taxation has been promoted for over 100 years as a method to free the real estate market from restrictions on development while raising revenue for public use. The current system taxes the combined values of land and buildings, and by doing so places an incentive on the real estate market to minimize development. Property owners are essentially penalized for building to the maximum capacity of a lot because those improvements lead to higher taxes; the bigger the building the more taxes are paid. A tax on land without consideration of the value of improvements or building, on the

other hand, is considered to be more neutral in its effect.

The premise of this approach is that increases in the value of a site are generally attributable to public investment in its surroundings and therefore are logically more subject to public recapture, whereas improvements on the site can be ascribed to the owner's efforts and investments. In theory, switching to a heavier land tax and a lighter tax on improvements will promote larger buildings in appropriate locations, maximize development capacity, prevent land banking and derelict areas, and promote rehabilitation and redevelopment. Development would be more likely to occur in areas near existing infrastructure where land values are highest.⁹

Under this proposal, land and structures would be taxed at different rates, with land taxed more heavily. Taxes on built property would decrease to create a revenue neutral result at the municipal level. The scenario examined for this report puts three quarters of the school tax burden on the land tax and one quarter on the property tax. For example, in West Caldwell Township in Essex County¹⁰, the land is valued at about \$391 million and the improvements at about \$721 million. The state equalized value of land is \$630 million. West Caldwell's current school property tax rate, which is based on both land and property value, is \$1.11, and raises about \$20 million. Under this scenario, 75% of the \$20 million would be raised from a land tax and 25% would be raised from a property tax. To accomplish that, the land tax would need to be \$2.38 and the property tax would be \$0.43. The immediate effect is clear: if a landowner were to invest \$100,000 in improvements for his property – for example, by adding an apartment – that landowner would only have to pay an increase of \$430 in local school property taxes instead of \$1,113 under the current structure.

This scenario was constructed to demonstrate how land can be taxed differently from built property with no change to the revenues or expenditures of municipalities. The shift in tax rates would theoretically encourage infill and higher density development in places with lower land costs.

Effect of Countywide Tax Rate on Municipalities...		Table 19 ...by Planning Area Category				Table 20 ...by Population Density Category						Table 21 ...by Abbott Status			Table 22 ...by Population Growth Category					Total Mun.
		Mixed	Urban & Suburban	Rural	Total	Very Low	Low	Med.	High	Very High	Total	Non-Abbott Districts	Abbott Districts	Total	Declining or Stagnant Population	Slowly Growing	Moderately Growing	Quickly Growing	Total	
If \$100,000 of improvements are added, how much less will the owner pay under the Split Tax plan than under status quo?	Save \$1,000 +	10%	54%	37%	100%	34%	53%	12%	1%	0%	100%	99%	1%	100%	46%	16%	15%	23%	100%	93
	\$800 to \$999	17%	37%	46%	100%	44%	45%	10%	1%	0%	100%	99%	1%	100%	14%	18%	27%	42%	100%	130
	\$600 to \$799	16%	47%	36%	100%	37%	40%	16%	6%	1%	100%	95%	5%	100%	17%	29%	29%	26%	100%	154
	\$400 to \$599	19%	65%	16%	100%	19%	50%	18%	10%	3%	100%	86%	14%	100%	11%	36%	32%	21%	100%	121
	\$200 to \$399	7%	77%	17%	100%	3%	60%	13%	13%	10%	100%	87%	13%	100%	10%	20%	53%	17%	100%	30
	\$1 to \$199	17%	33%	50%	100%	37%	57%	3%	3%	0%	100%	100%	0%	100%	33%	33%	10%	23%	100%	30
	Pay \$0 or more under SPLIT plan	0%	0%	100%	100%	50%	50%	0%	0%	0%	100%	100%	0%	100%	38%	25%	13%	25%	100%	8
Total	15%	50%	35%	100%	32%	48%	14%	5%	1%	100%	95%	5%	100%	20%	25%	27%	27%	100%	566	
Municipalities		86	283	197	566	185	269	76	28	8	566	535	31	566	116	144	152	154	566	

Land Use and Social Equity

Consistency with State Plan goals

High

Were the state, or even all the municipalities in a county or sub-county region, to switch to split rate taxation, it is likely that demand would increase for new housing and commercial development. This pressure would theoretically be strongest in places with the highest zoning envelopes, such as infill lots in Newark, Paterson and other cities. The tax system would direct growth toward smaller lots with higher density zoning and make other areas less attractive from a tax perspective, such as large lots in rural and outer suburban single family residential areas. Although the higher land taxes in greenfield areas might induce more landowners to try to subdivide their property for development, there will likely be less demand to develop this property. This conclusion is supported by academic research, including findings from a study by Jan Brueckner. Using a model that predicts development, he found that increasing the proportion of the tax on land results in higher density and less sprawl at the metropolitan scale.¹¹ The result would be consistent with State Plan goals, leading to more development in urban and suburban centers and less in rural areas.

Consistency with affordable housing goals

High

Split rate taxation would likely lead to an increase in housing overall, and specifically an increase in higher density housing and infill residential development in cities. Most importantly, it would increase incentives to develop more housing since taxes on new development would be reduced. Also, although Table 20 shows no clear pattern in how taxes would change by the density of the municipality, there is a consistent body of literature to support the conclusion that higher density, more multi-family housing is a likely result.

Education equity

Moderate

Consistently, this plan would have a modestly positive effect on education equity. All of the Abbott Districts are in municipalities that would benefit from the proposal to some degree, although most are not in the category of those municipalities that would benefit the most.

Efficiency and Fiscal Health

Flexibility

High

Municipalities would have the same ability to change rates as they do now. However, by being able to change the rates on either land or improvements, it should be easier for tax revenues to adjust to changes in the economy without changing rates that would inhibit new development. Table 22 shows no clear pattern of the plan's affect on municipalities categorized by population growth.

Fiscal discipline

Moderate

This proposal should have no effect on fiscal discipline. There is no change in who is taxed and who has responsibility for setting tax rates and school budgets. It simply reforms how property is taxed.

Fiscal stability

Moderate

There would be no shift to less stable taxes and little effect on the stability of local revenue at different points in the business cycle.

Local autonomy

High

More than most of the other proposals, split rate taxation would preserve the fiscal autonomy of local governments. The proposal would not change the total amount of local collections or the level of government where taxes are collected or tax rates are decided, and there would be no incentive, beyond what already exists, for the state to impose spending mandates or constraints.

Summary

This proposal ranks relatively high on both sets of criteria—land use and social equity as well as efficiency and fiscal health. However, it also faces some of the greatest implementation barriers. Its benefits are difficult to grasp intuitively and there are few actual models of places that have implemented this form of taxation. There are also the technical difficulties of revaluing property accurately and the political hurdles of increasing taxes for some classes of property holders.

⁹ Briefing paper “Should Land and Buildings Be Taxed Differently?” prepared for March 23, 2005, roundtable at Rutgers University, Newark, NJ, entitled Fundamental Property Tax Reform: Land Use, Regulatory and Fiscal Reform in New Jersey. http://www.rpa.org/pdf/TaxForumThreeDifferentialTax_Brief.pdf

¹⁰ West Caldwell Township was chosen because both its population density and its land-to-improvements ratio are close to the state median.

¹¹ Brueckner, Jan. “Property Taxation and Urban Sprawl,” in Wallace Oates, editor, Property Taxation and Local Government Finance, Lincoln Institute of Land Policy, Cambridge MA, 2001.

Conclusion

The ranking of each proposal by criteria provides an indication of which reforms would be best suited to different goals. Table 23 summarizes the findings for the five proposals by ranking each Low, Moderate or High for each of the criteria. These broad categories capture the general direction of change. In some cases, the analysis indicates a clear shift in incentives and probable outcomes, while in others the effects are clouded by data limitations or ambiguities that are difficult to test. However, the results allow us to characterize which proposals are likely to have the greatest potential to meet multiple objectives.

One important characteristic that the results do not show is political viability. This was a deliberate choice in framing the criteria, since one objective of the exercise is to encourage both citizens and public officials to consider novel concepts and politically difficult choices. However, some discussion of implementation hurdles is needed for any of these ideas to receive serious discussion. The following conclusions therefore incorporate both the analysis of the criteria and the political context for implementation.

Somewhat surprisingly, the two proposals that do the least to improve land use and social equity are the **two proposals that shift school property taxes from the local level to the state or county level** by instituting uniform rates at these higher jurisdictional levels. In theory, these should have lowered rates in poorer, more urban areas, increased incentives to comply with the State Plan and reduced inequities in tax burdens. However, the results were generally either neutral or negative on these criteria. These outcomes appear to result from two factors. One is that state grant programs already mitigate the inequities of the tax system to some extent by providing more aid to poorer school

districts. The second is that wealthier districts can and do choose to tax themselves at higher rates to produce superior schools. With a wealthier population and better schools to start with, higher tax rates may seem less burdensome and result in a better product than in poorer districts. If this is the case, then shifting the tax burden upward to the state or county could still be effective, but it would have to involve a comprehensive reform of grant programs and some differentiation of rates by type of place.

Varying taxes by State Plan category provides a much stronger realignment of incentives because it consciously redirects the tax burden toward places where development is to be minimized. This favors urban and poorer districts and results in positive effects for land use, affordable housing and education equity criteria. Rankings on efficiency and fiscal health criteria are mixed. The one low ranking—local autonomy—indicates that this proposal would face difficult political hurdles. The “losing” municipalities would be evident from the start and could be expected to vociferously oppose this reform.

The **income tax substitution** proposal also generates positive housing and social equity effects, but for different reasons. By shifting the tax burden from school property to income taxes, it lowers effective property tax rates across the board and increases incentives for new development. The additional income tax burden would be felt most strongly in wealthier towns, so it would encourage greater equity as well. It also has mixed rankings for efficiency and fiscal health criteria. Its political difficulties would stem less from its impact on local autonomy, since school districts would retain budget control while not having to raise as much in local taxes, than from resistance to any increase in income taxes. The main policy concerns are that it would increase the instability of the state’s tax base and weaken spending constraints on school districts. Also, further research is warranted to determine how changes in both income and property tax rates would affect competitiveness with other states.

Split rate taxation receives high or moderate rankings for all criteria. It strongly encourages affordable housing by lowering the effective tax rate for new development and provides greater efficiency and flexibility without negative impacts on the other criteria. However, its main impediment is that it would be difficult to implement, even leaving aside any political considerations. It would require a dramatic restructuring of how property is taxed and would require local as well as state action to implement. There is also a limited number of empirical test cases that can be examined for impacts. This reform may deserve serious attention, but is unlikely to be the sole vehicle for reforming New Jersey’s tax system.

Developing a Research and Action Agenda

The twin purposes of this report are to assess several proposed ideas for reforming school property taxes and to suggest a common framework and methodology for comparing other proposals. As with most research projects, the analysis in this report both provides new information and raises additional questions. There are several ways in which the research could be refined or expanded. A regression or correlation analysis could determine more precisely which relationships are statistically significant. The effects of the proposals on economic growth or property values could also be modeled with sufficient information and specification of other relevant variables. There is also an infinite number of variations in the types or details of reform proposals that could be tested. An obvious expansion of this research would be to look at the impact of proposals for reforming the non-school portion of local property taxes.

The results of this analysis also lead to the conclusion that a combination of reforms may be most effective for addressing multiple objectives. None of the proposals is clearly superior on all criteria, and there may be ways of combining elements of different ideas to produce optimum results. For example, combining the income tax substitution proposal with some form of either variation by State Plan area or split rate taxation could address some of the shortcomings of each concept.

Given the urgency for property tax reform in New Jersey, there is a limit to how much additional research can be performed before reform proposals will be considered and adopted. However, using this framework can help narrow the list of viable proposals, target additional research and provide a common base of comparison for different reforms. Over the next several months, a few ideas are likely to emerge as the leading contenders for property tax reform. A refined version of this framework, or a similar model that allows for apples-to-apples comparisons across a broad range of indicators, should be incorporated into the legislative process that will select and enact comprehensive reforms.

Table 23

Reform Scenarios Rated by Criteria	Reform Scenario				
	Vary by State Planning Area	Statewide Rate	Countywide Rate	Income Tax Substitution	Split Rate Taxation
Land Use and Social Equity					
Consistency with State Plan	High	Moderate	Moderate	Moderate	High
Housing Affordability	Moderate	Moderate	Moderate	High	High
Education Equity	High	Low	Low	High	Moderate
Efficiency and Fiscal Health					
Flexibility	High	Low	Moderate	Moderate	High
Fiscal Discipline	Moderate	Moderate	High	Low	Moderate
Fiscal Stability	Moderate	Moderate	Moderate	Low	Moderate
Local Autonomy	Low	Low	Moderate	High	High

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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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