



**FUNDAMENTAL PROPERTY TAX REFORM:
LAND USE, REGULATORY AND FISCAL REFORM IN
NEW JERSEY**

**WELCOMING FAMILIES BACK:
SCHOOLS, HOUSING AND THE END OF
'FISCAL ZONING'**

A Policy Roundtable Sponsored by Regional Plan Association and the Lincoln Institute of Land Policy

Wednesday, March 9, 2005
The Municipal Land Use Center
The College of New Jersey, Ewing, NJ

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Regional Plan Association

FUNDAMENTAL PROPERTY TAX REFORM: LAND USE, REGULATORY AND FISCAL REFORM

Sponsored by Regional Plan Association and the Lincoln Institute of Land Policy

Roundtable 2

What Tax Structures and Public Education Finance Reform Could Reduce Fiscal Opposition to New Residential Development?

Wednesday, March 9, 2005

The College of New Jersey

Paul Loser Hall

Ewing, New Jersey

- 3:00pm Registration and Reception
- 4:00pm Welcome
Thomas G. Dallessio, Regional Plan Association
Dr. Martin L. Bierbaum, The Municipal Land Use Center at The College of New Jersey
- 4:15pm Welcoming Families Back to New Jersey: Schools, Housing and the End of 'Fiscal Zoning'
Moderator: *President R. Barbara Gitenstein, The College of New Jersey*
The Problem of Fiscal Zoning
Alan Mallach, National Housing Institute
Case Study: Sustainable School Funding in Michigan
Dr. Douglas Roberts, Institute for Public Policy & Social Reform, Michigan State University
Case Study: Zoning and Funding for Housing and Schools in Massachusetts
Ted Carman, Concord Square Development Company, Inc.
- 5:30pm Questions and Answers
- 6:15pm Concluding Remarks
Christopher Jones, Regional Plan Association

Fundamental Reform: New Jersey's Property Tax Burden

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

The current system relies heavily on property taxes for revenue; for fiscal year 2001-2002 over 65% percent of all taxes collected in the state were local taxes, with over 75% of these coming from property taxes. Compare this to all municipalities in the nation, where 60% of local revenue is from local sources, and 45% is from property taxes. New Jersey's heavy reliance on local property taxes results in wide discrepancies in the resources available to different municipalities, and, ultimately, to rising property taxes that hurt lower- and fixed-income households. Heavy reliance on locally-collected property taxes also creates competition among municipalities for development that brings with it fiscal benefits. This often leads to perverse land use decisions, including limitations on residential land uses that restrict the supply of housing. Further, the system creates competition among municipalities, rather than the cooperation needed to keep down costs of providing public services. With 21 counties, 566 municipalities, 611 school districts, and 400 local authorities and fire districts, New Jersey has a highly fragmented governance structure that keeps the cost of providing public services higher than if some of these services were provided cooperatively.

Public interest in property tax reform has created an opportunity for fundamental reform of this highly fragmented fiscal system. To take advantage of this opportunity, Regional Plan Association and Lincoln Institute of Land Policy are co-hosting a series of panel discussions in anticipation of the proposed property tax convention. These forums will illuminate the relationship between fiscal policies and the landscape in which we live. The first panel was held on February 23, 2005, and was entitled "How Can We Afford Smart Growth?". The second panel, entitled "Housing and School Funding" and to be held on March 9, will examine reforms with the potential to ensure sufficient school funding and an adequate supply of housing. The third panel, "Differential Taxation for Land and Buildings," will address the question of whether land and buildings should be taxed differently. This paper serves as a briefing paper for the second of the panel discussions.

Welcoming Families Back to New Jersey: Schools, Housing and the End of ‘Fiscal Zoning’

“Almost everyone acts solely in its own selfish and parochial interest and, in effect, builds a wall around itself to keep out those people or entities not adding favorably to the tax base, despite the location of the municipality or the demand for varied kinds of housing.¹”

The Problem of Fiscal Zoning

When municipalities use zoning regulations to improve their tax base by attracting firms or households whose contributions in taxes exceed their use of public services, they are engaging in a common practice called fiscal zoning.² Fiscal zoning is often used to exclude those land uses where the added cost of public service exceeds (or is perceived to exceed) tax revenue generated by those uses. Since property taxes are already high and since property taxes are the chief source of revenue for public schools, fiscal zoning has become the norm in New Jersey. Many New Jersey towns are pulling up the proverbial drawbridge and saying “no” to any new residential development. The conventional wisdom in New Jersey argues that new housing leads to new school children, which leads to even higher taxes³.

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

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

¹ Southern Burlington County NAACP v. Township of Mt. Laurel, 67 NJ 151 at 171, 336 A2d 713 at 723 (1975).

²J. M. Pogodzinski. “The Effects of Fiscal and Exclusionary Zoning on Household Location: A Critical Review.” Journal of Housing Research Volume 2. Issue 2 (1991): 145-160.

³ The Regional Planning Partnership estimates that 0.82 school children are added for every 3- or 4-bedroom home, and 0.15 school children for every 1- or 2-bedroom home; the common perception is that all housing, other than age-restricted housing, brings many more children.

Michigan and Massachusetts have attempted to resolve this dilemma, but have found alternatives with considerably more promise. This policy roundtable features the key architects of those reforms to discuss how they were conceived, developed, and implemented. The roundtable will provide an opportunity to discuss the political realities around these policies, their limitations and promise. The two approaches are described here.

Massachusetts

This past summer (2004), Massachusetts passed a bill to begin using Smart Growth Zoning Districts. The districts were conceived as a tool to simultaneously encourage transit-oriented, affordable housing development and, over time, more equitable school funding. The idea was remarkably simple: the state would provide towns with smart growth sites an opportunity to earn real dollars-per-unit for upzoning. All development in the new zones would have an affordable housing component so that 20% of units are affordable to households earning less than 80% of area median income. Eligible towns are those with transit stations, town centers, or underutilized industrial, commercial and institutional space.

In the original bill, the state would make up the difference in added school funding costs which result from development. To the dismay of its architects and proponents, the version of the bill that passed in Massachusetts excluded the promise of school aid reimbursement. However, it did include a solid framework for moving forward with the concepts, including significant incentives to local communities for Smart Growth Zoning. As a result, the development of the legislation (by a private developer, housing advocate, and academic), the research and theory underlying it, and the politics around it may be informative to states such as New Jersey as they tackle the same problems.

The policy's architects believe that production is the key to balancing out the housing market: land will stay cheap if more than enough of it is zoned as-of-right at higher densities in the right places. Cheaper land will make it feasible for developers to fill the demand for housing even with affordability and smart growth site restrictions. The problem is getting towns to adopt zoning to make this possible. Massachusetts' Smart Growth Zoning Districts are meant to encourage towns to adopt appropriate zoning by neutralizing the fiscal impact when municipalities allow affordable housing.

The density bonuses themselves, which were adopted by the state, are fairly strong. Towns will receive approximately \$4,000 for each home that gets developed in the zones, with 1/4 of that paid upfront and 3/4 paid when the building permits are granted. With the school funding reimbursement element in place, the policy was expected to generate over 30,000 new housing units at a cost to the state of about \$360,000,000 over ten years in bonuses and school funding offsets. The plan shows that these costs would be mitigated by significant revenue gained from economic growth as well as the sale of state land in this effort.

Massachusetts' Smart Growth Zoning districts were developed in a state that, like New Jersey, already had an affordable housing provision in place. The Massachusetts state statute, chapter 40 B (also known as the Comprehensive Permit Law) has been in place since 1969. It expedites affordable housing developments by streamlining the approval process and

empowering the zoning board of appeals to approve developments that may be inconsistent with local zoning code in order to make them financially feasible. Usually, this means the zoning board approves higher density and multifamily developments where the local zoning code prohibited it. As a result of 40 B, more than 35,000 housing units in more than 200 communities have been built. (The state of Massachusetts has a goal of 10% affordable housing statewide and it credits 40 B for its considerable progress toward that goal.) New Jersey's affordable housing provisions, created under the Fair Housing Act of 1985, have resulted in 66,600 affordable units according to the Council on Affordable Housing⁴.

Michigan

In the mid 1990s, Michigan's Proposal A drastically reduced public education's reliance on property taxes. This required a major commitment to equitable education at the state level, in the form of an increased sales tax. Local property taxes were decreased in most places, and a 'foundation' level of school funding was guaranteed across the state.

Proposal A shifted the sources of funding for K-12 public education: local property taxes were reduced from over 60% to approximately 32% of the total funding for public schools. The rates of state taxes also changed, with the most significant change being in the state's sales tax, which increased from 4% to 6%. The bill included a new funding distribution formula intended to maintain the same level of per-pupil revenues available to each local school district that the district had prior to reform. Some districts, however, could expect an increase in funding each year. In order to address equity in funding across the state, those with the lowest revenue levels experienced the greatest increases, and those at the highest levels experienced the smallest increases. Budget decision-making was shifted to the local district by combining many previously earmarked funds into a foundation grant. That is, the same total level of funding is available but decisions as to which programs to continue or expand and which programs to reduce are the responsibility of the local district.

Ten years on, there is a wealth of information on whether the bill achieved its goals and how it could be applied to other states. Since Proposition A was adopted, the gap in per-pupil spending between the highest and lowest spending school districts narrowed considerably. Michigan moved from having property taxes 39% higher than the national average to only 4% higher. Per capita, Michigan had the 8th highest property taxes before Proposition A; it is now around the 18th highest. However there remain concerns over the stability of the revenue sources for school funding, and the mismatch between revenue and costs. Proposal A has been criticized for not providing sufficient resources in total, in addition it has been criticized for adopting a spending formula which does not adjust for either differences in cost of living or declining enrollment.

⁴ Adjusting for the total number of housing units in the state, the New Jersey affordable housing program has created one and half times more affordable units than the Massachusetts program. However, the programs are very different, with different definitions of 'affordable', and various stipulations regarding age restricted housing, funding for services, and off-site affordable housing. The two programs are not strictly comparable.

New Jersey's Policy Context

New Jersey already has affordable housing and equitable school funding legislation in place. Both came in the form of lawsuits. The Council on Affordable Housing (COAH) was created through the Mt. Laurel decisions in the early 1980s. Administered through the Department of Community Affairs, COAH determines the number of affordable units each municipality is obligated to build. COAH grants certifications to municipalities with affordable housing plans. Those municipalities without certifications are vulnerable to the builder's remedy: developers can sue municipalities for rejecting their proposals.

In education, Abbott Districts were created from a series of lawsuits beginning with the Abbott v Burke decision of 1981, requiring the state to give additional funds to the poorest urban districts to bring their per-pupil expenditures close to those of wealthy suburban districts. The state is required to meet a minimum aid obligation each year, which is determined through a formula. The courts do not specify where this funding should come from; Abbott remedies have come from the state general fund. Abbott is widely seen as successful⁵. New Jersey is considered to have equitable and adequate school funding overall; the gap between the highest and lowest need districts has narrowed thanks to Abbott, and per-pupil spending is among the highest in the country. In addition to making education more equitable across the state, and also in response to Abbott, the state has created a bonding program for new school construction and a preschool funding program. These programs benefit both Abbott and non-Abbott school districts⁶.

New Jersey also already has various forms of property tax relief⁷. The state provides aid to counties and municipalities for property tax relief (\$2 billion in 2000) and to individuals through tax deductions and programs such as the homestead rebate, which came to \$800 million in 2000.

Direct and Indirect State Aid to Reduce Property Taxes	\$ Millions in FY 00
Energy Receipts Tax Program	\$750
Consolidated Municipal Property Tax Relief Program	\$768
Municipal Block Grant (per capita revenue sharing)	\$33
Extraordinary Aid (for smaller municipalities)	\$30
Indirect State Aid to Counties	\$400
Individual Property Tax Relief	
Homestead Rebate	\$348
School Assessed Value Exemption Rebate	\$170
Deduction of Property Tax from Income Tax	\$250
Senior Citizen Property Tax Freeze	\$23
Veterans Property Tax Rebate	\$17
Total	\$2,789

⁵ Kevin Carey. "The Funding Gap 2004: Many States Still Shortchange Low-Income and Minority Students." *The Education Trust*. (2004) <<http://www2.edtrust.org/NR/rdonlyres/30B3C1B3-3DA6-4809-AFB9-2DAACF11CF88/0/funding2004.pdf>>.

⁶ While the state is obligated to fund Abbott districts, it is not obligated to provide aid to other school districts.

⁷ Judith C. Cambria. "Patchwork Property Tax Relief: How to Make a Bad System Better." *New Jersey Policy Perspective*. January 2000. <http://www.njpp.org/rpt_cambria.html>. This report is also the source for the table.

These three existing policies – housing, school and property tax relief – would be affected by any future change in the way property taxes are collected in New Jersey. Capping property taxes might necessitate raising taxes elsewhere, as there would be a higher burden on other revenue sources for housing and schools. Changing the structure of property tax relief may affect some municipalities and individuals differently depending on how they have fared under the current patchwork of property tax relief programs. Solutions need to be meaningful in the current context; changes should not exacerbate fiscal zoning. Past reforms were established to help move New Jersey toward many of the same goals now being discussed.

Proposed Solutions

Some might say that the property tax relief programs listed above, as well as affordable housing and school funding, are just what New Jersey has to spend to keep a broken system functional from year to year. Structural changes may be necessary to find a more sustainable, and ultimately less expensive, solution. Structural changes might come in various forms:

- fiscally-neutral zoning incentives, as in Massachusetts;
- lowering property taxes and finding a new revenue source at the state level, as in Michigan;
- carefully combining various tax code, accountability, and governance changes, as have been suggested by the Cahill Committee, SLERP Commission and others⁸;
- or tax base sharing, which has a precedent in the Meadowlands.

Jurisdictional consolidation is another possible structural change, which is often cited as capable of addressing the underlying causes of fiscal zoning. Reports by New Jersey Policy Perspective, New Jersey Future and others have pointed out that fragmentation of government exacerbates the mismatch between wealth and needs. The fragmentation is evident in the number of school districts (616) and municipalities (566), and inequity is evident in the differences in tax rates across the state (from less than \$1 per \$100 of assessed value, to more than \$10). Similarly, New Jersey Senator Bob Smith has proposed consolidating school districts by county. Senator Smith writes that consolidation would dramatically reduce costs by eliminating duplication of services, including transportation, maintenance and purchasing. It would also facilitate the efficient creation of specialty schools focused on the arts, technology, and vocational training. However, many feel that consolidation is politically unfeasible.

Overall, most smart growth proponents and housing advocates would reject a no-growth future for New Jersey. They envision a future with a broad range of housing types, affordable to residents at all income levels and in different stages of life, developed in such a way as to decrease road congestion and shorten commute times. This needs to be achieved along with equitable school funding to fulfill New Jersey’s constitutional mandate of a “thorough and efficient education” for all students. The roundtable will discuss how New Jersey can address these issues in the context of property tax reform.

⁸ Henry A. Coleman. “Tax Reform in New Jersey: The Commission Approach.” New Jersey State League of Municipalities. April 2003. <http://www.njslom.org/tax_reform_04-2003.html>.