NEW JERSEY POLICY PERSPECTIVE

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THE GOOD, THE BAD AND THE ERGLY

Developers can tap into 19 state and local revenues for private projects in more than 80% of New Jersey municipalities.

By Sarah Stecker
POLICY ANALYST

In late 2008, a major Wall Street financial services firm let it be known it was thinking about moving its offices from New York to New Jersey. The subsequent wooing of the Depository Trust & Clearing Corporation (DTCC) lasted more than a year. New Jersey finally bested New York and closed the deal with a newly minted tax subsidy, the Economic Redevelopment and Growth (ERG) Grant Program, which pushed the total taxpayer assistance offered to DTCC to more than $100 million.[1]

The $14.6 million ERG grant will be financed from a portion of the corporate business taxes DTCC would otherwise be obligated to pay the state.[2] The grant can be paid to the company for a term of up to 20 years. ERG is the state's newest tax increment financing program – a form of subsidy to developers used across the country — and the focus of this paper.

The Depository Trust & Clearing Corporation is a financial behemoth that provides clearance and settlement services for equities, bonds, securities and derivatives. In 2009, DTCC settled more than $1.48 quadrillion[A] in securities transactions and had net income of $104.7 million.[3] With the help of experienced site location consultants, DTCC solicited aggressive subsidy packages, pitting New Jersey against New York.[4] One New York official said that New Jersey was "offering the moon" to DTCC.[5] In the end, DTCC chose New Jersey and will move 1,600 jobs to Jersey City by 2013. DTCC will keep 700 jobs, including the company's executives, at 55 Water Street in lower Manhattan, where the company has been headquartered for decades.

New Jersey was a persistent suitor. Over months of negotiation, its package of subsidies grew from a single $74.6 million state jobs grant to a $100.2 million multi-subsidy package that involved the state, county and city. The firm pressed the state to up its offer because, according to officials' description of the negotiations, New Jersey was in a "marginal situation" as compared with New York.[6]

In the end, New Jersey gave DTCC a $74.6 million Business Employment Incentive Program (BEIP) grant for moving the 1,600 jobs and a $14.6 million ERG grant for building renovations. Further, Hudson County chipped in $5 million of its $15.1 million allocation in tax-exempt Recovery Zone Facility bonds from the American Recovery and Reinvestment Act.[7] Last, Jersey City gave the firm $5 million of its $9.7 million allocation in federal tax-exempt Recovery Zone Facility bonds, as well as $1 million in Urban Enterprise Zone (UEZ) relocation grants to be paid out over four years.[8] At the 2010 awards gala for NAIOP-NJ, the commercial real estate trade association, DTCC received NAIOP's "2010 Creative Deal of the Year Award," for its "creative use of lease and incentives," especially the first use of ERG.[9]

[A] One quadrillion is otherwise known as one thousand million million because the number contains 15 zeros. When written out long-hand, DTCC's volume of transactions looks like this: $1,480,000,000,000,000.

New York's subsidy offer has not been publicly disclosed but, Jay Biggins, executive managing director of Biggins, Lacy, Shapiro & Co, the site location consultant that represented DTCC, said, "New York State and New York City were both actively involved. They were calling on the company's leadership and were creative and aggressive about making their proposals."[10] However, a spokesman for New York City's Economic Development Corporation, in a newspaper account, soft-peddled the idea that New York got into a bidding war. "In the long term, investing taxpayer money to keep the city a place where businesses want to be, rather than simply matching what other cities are willing to give away, will generate the greatest return for our taxpayers."[11]

INTRODUCTION

About one year ago, on July 28, 2009, New Jersey's newest version of a tax increment financing law (TIF), called the Economic Redevelopment and Growth (ERG) Grant Program, became law. This paper examines the previous and current versions of New Jersey's TIF law and how the new TIF subsidy compares to similar subsidies in other states. Importantly, the paper examines the potential of New Jersey's new TIF program to divert millions of dollars from 19 different state and local revenue sources for up to 20 years per project – diverting those revenues from essential public services to business interests in at least 80 percent of the state's municipalities. Lastly, this paper considers how the ERG program could be strengthened, building on some current positive provisions, to better assist economically struggling municipalities, safeguard taxpayers' investment in economic development and protect vital public services from significant revenue drain.

I. BASICS OF TAX INCREMENT FINANCING (TIF)

What is TIF?

Tax Increment Financing (TIF) is a complicated business subsidy offered across the country for economic development purposes. First adopted in California in 1952 to help revitalize blighted and impoverished areas, TIF is now authorized by 49 states and the District of Columbia.[12] TIF subsidies can be given by states, counties and municipalities.

The pervasiveness of TIF differs across the states. California, for example, has hundreds of TIF districts; other states, including New York, use it sparingly.[13] In fact, New York City, which competes most often with New Jersey for new businesses, has no TIF projects.[14]

Tax increment financing works this way: A municipality wants to redevelop a closed factory and the property on which it sits. Since both the factory and land are not in use, both would have relatively low property values and tax assessments. The site's property tax assessment would be called the "pre-TIF assessment" or "base value." The municipality — and perhaps the state — offers the developer a slice of the improved property's increased tax value as a subsidy to pursue the redevelopment. Following the award of the TIF subsidy, those base value property taxes would continue to support public services provided by the town, school district and county. Once the developer builds say, an office park on the site and attracts tenants, property values and property tax assessments increase. This is called the "tax increment." The increment is used to subsidize the new development – the office park – rather than supporting the public services, such as schools, police and fire protection, needed by the office park's workers and others who live and work in the town.

State laws vary as to when TIF subsidies can be paid. Some states and cities sell bonds and use the cash raised from the bond sale as the tax increment financing given to the developer. Then, if the new development succeeds, the increase in tax revenues – the increment – is used to repay the bonds. But if the finanacing fails cities will scramble to meet bond obligations for fear of not being able to pursue future deals. Cities in other states, including Missouri and Texas, have dipped into city budgets to repay the bonds, which forced them to cut public services in order to balance their budgets.[15]

Some states and their cities, including Massachusetts, Kansas and Minnesota, use a less risky pay-as-you-go method.[16] Under this scenario, developers are given the TIF funds after their project has generated sufficient taxes to pay the subsidy. In 2009, New Jersey moved from a TIF program that sold bonds upfront to a pay-as-you-go program. This was a positive step to safeguard taxpayers.

Whether a state uses bonds or pay-as-you-go, the tax increment financing comes from diverted taxes. The tax revenues that can be diverted vary across states. As a result of the 2009 legislation, New Jersey is now the most generous in the country in terms of the number of incremental revenues – 8 state and 11 local – that can be diverted from public to private use in TIF. Other states are far more prudent with their revenues; most states do not allow state taxes to be diverted to tax increment financing.[17] Twenty-nine states allow only the property tax to be diverted to TIF, according to the Council of Development Finance Agencies, a national association of state, county and local development finance agencies.[18]

A Brief History of TIF in New Jersey

Tax increment financing first appeared in New Jersey in 1984. But, it had been used sparingly. For example, under the tax increment financing law in effect from 2001-2009, only one TIF district was approved. However, since the new law was adopted in July 2009, five projects have been approved and two others proposed. The generosity of this new developer subsidy may explain, in part, why more subsidies have been proposed and approved, than under any previous TIF law. The potential of this new developer subsidy to drain massive funding from public services is highly troubling.

In 1984, New Jersey first authorized municipalities to use tax increment financing to encourage private investment in under-utilized and blighted areas, after a developer expressed interest in such a project in New Brunswick. But the TIF law enacted in 1984 was never used and was repealed in 1996 when the state adopted the New Jersey Redevelopment Act.[19]

Tax increment financing returned to New Jersey in 2001, with the creation of Revenue Allocation Districts (RADs). Like the 1984 law, the RAD law was introduced at the request of a developer who hoped to use it to fund a project. RAD authorized the diversion of 11 tax revenues to development in the district, including one state-level tax and 10 local taxes.

The 2001 law allowed municipalities to establish RADs only in redevelopment areas – a planning designation governed by statutory criteria in the state's Local Redevelopment and Housing Law. The districts could be structured in a way that returned all of the incremental gain in taxes to the new development itself or invested part of the increment in improvements to properties elsewhere in the district. The Millville RAD returned a portion of the increment to the developer while investing the remainder elsewhere in the district – a positive policy for redevelopment in an economically distressed municipality. The Millville Revenue Allocation District was grandfathered into the state's new tax increment financing law.

The law was not used for four years after it passed, until the City of Millville applied to establish a RAD in the northern and central sections of Millville. The Millville RAD is 821 acres, including about 60 acres in a shopping center in the northern part of the city that generates most of the district's tax revenue. The shopping center includes a number of big-box retailers including Target, Kohl's and Dick's Sporting Goods. In 2006, the year the RAD was established, slightly more than 17 percent of the city's total assessed value was included in the district.[20] Money from the bond proceeds have been used to reimburse the shopping center's developers $2.5 million – $1 million to Target and $1.5 million to the developer of the rest of the project, known as the Goodmill Shopping Center.

The city uses the incremental revenues, along with grants it receives from the state and federal governments, to improve homes and infrastructure in the Third Ward, the Center City and South Millville. These latter areas have lower homeownership rates and higher crime rates than other portions of the city.[21] As of March 2009, Millville had used money from the bond proceeds to rehabilitate 53 homes, pursue code violations against hundreds of properties, help 13 people purchase homes

Incremental Revenues Diverted under the New Jersey Revenue Allocation District (RAD) Financing Law of 2001

- State sales taxes that municipalities keep under state Urban Enterprise Zone (UEZ) program
- Property taxes
- Payments in lieu of taxes (PILOTs)
- Local payroll and wage taxes (Newark only)
- Parking taxes from facilities in the RAD
- Lease payments made to government entity running the RAD
- Parking revenue from public parking lots as part of a RAD project
- Admission fees and state sales taxes from public facilities in the RAD
- Assessments against properties approved by municipality
- Federal and state aid
- Mortgages held by government entity running the RAD
- Any cash, accounts or securities of government entity running the RAD

Source: New Jersey Revenue Allocation District Financing Act of 2001 in the district and begin relocating the residents of a rundown apartment complex, which the city hopes to replace with 36 single-family homes, including six affordably priced units.[22]

Although the RAD law allowed municipalities to use all of the tax increment generated in the RAD for projects in the district, Millville had committed to using only half of the increment this way. The remaining half, $25.3 million, has been disbursed to the city's general fund, school district and county, as it would have been otherwise.[23]

TIF in Neighboring States

New Jersey is often compared with its neighbors, New York and Pennsylvania, in terms of the business subsidies offered by each. These states compete fiercely for new businesses and relocations across their common borders. New Jersey is often described as having more business regulations and rules and less generous subsidies then its neighbors. However, New Jersey's ERG program is by far, the most generous and least restrictive when compared with those of its neighbors.

Notably, New York City has no operating tax increment financing supported projects. New York State's TIF law, enacted in 1984, diverts only the local property tax.[24] But, New York law does not allow its entire property tax to be diverted – the school portion of the property tax is shielded from TIF projects.[25] New Jersey has no such prohibition. Further, in New York, TIF funds may be used only for limited purposes including land acquisition, site preparation and public infrastructure such as streets and sewer systems.[26] New Jersey law allows tax increment financing to be used for all types of development: "the clearance, development or redevelopment, construction or rehabilitation of any structure or improvement of commercial, industrial, residential or public structures or improvements."[27]

Case Study: Atlantic City

In November 2009, Revel Entertainment Group submitted what became the most controversial ERG grant application. Revel, which at the time was almost exclusively owned by Wall Street bank Morgan Stanley, applied for a $300.7 million state grant it said was needed to complete its luxury mega-casino with 1,900 rooms, several restaurants, shops, a theater, health club and spa.[1] Revel also applied for a $50 million local ERG grant for the same project. In its grant applications, company officials proposed using diverted state hotel and motel taxes and state sales taxes to pay for the state ERG grant and diverted property taxes to pay for the local grant. At the time, Atlantic City had already granted Revel $106 million for public improvements in the area surrounding the casino, including $50 million in property tax abatements and $56 million in tax free municipal bonds.[2]

The investment would have been risky for both the state and city. Atlantic City's popularity as a gambling destination has declined in recent years, as competition from neighboring states has grown. Although Revel's supporters claim the new mega-casino is needed to help return Atlantic City to a tourist destination, the future of Atlantic City's casino industry is far from certain. Revel's opponents, including Atlantic City's largest casino service workers' union, have questioned the use of public money to help fund a casino and said they believe Revel's opening would force several of the city's smaller casinos to close. Public sentiment also appears opposed to the idea, with three out of five people saying they did not believe Revel should receive taxpayer dollars, according to a Fairleigh Dickinson University PublicMind poll.[3]

In April 2010, Morgan Stanley, which owned 94 percent of the casino, reported that it had lost $932 million of its $1.2 billion investment in the project and would sell the project.[4] The announcement prompted Revel officials to withdraw their state ERG grant application from the Economic Development Authority.[5] However, Revel President and CEO Kevin DeSanctis has said the application for the state grant will be resubmitted after a new investor is found.[6] The application for the local ERG grant was withdrawn the day before it was scheduled to be heard by the Local Finance Board. It has not been replaced on the agenda and has not been mentioned by Revel officials.

Pennsylvania's TIF law, enacted in 1990, is not as broad as New Jersey's. Pennsylvania allows the diversion of four taxes to tax increment financing projects, unlike New Jersey which allows 19 revenues to be diverted.[28] Pennsylvania allows TIF money to be given directly to the businesses benefitting from the subsidy, but Pennsylvania law also requires that an analysis of the social, economic and financial effects of the TIF law be completed every two years and the report be given to the governor and the state Assembly.[29] New Jersey has no such evaluation requirement.

II. BASICS OF THE ECONOMIC REDEVELOPMENT AND GROWTH (ERG) GRANT PROGRAM

Passage of the ERG Law

The New Jersey Economic Stimulus Law of 2009 created the Economic Redevelopment and Growth (ERG) Grant Program, the state's new TIF subsidy. The bill, A-4048, was sponsored by Senator Ray Lesniak and others. It was introduced June 11, 2009 and was passed only two weeks later by both the State Senate and Assembly on June 25, 2009. Although a number of legislators cosponsored the bill, Senator Lesniak was among its most vocal supporters.[30] Even though the bill allows billions in taxpayer dollars to be given from an array of business subsidies, including ERG, no cost analysis of the bill (called a fiscal note) was done by the Executive Branch or the Legislature. The bill was signed by then-Gov. Jon Corzine a month after its passage, on July 28, 2009, at a public signing alongside Newark Mayor Cory Booker at the Newark Penn Train Station.[31]

About a year later, in 2010, the Economic Redevelopment and Growth Grant Program was changed by a second bill, S-920. Among other things, it eliminated a municipality's role in accepting or rejecting a project supported by a state ERG grant.[32] The impetus for this second bill came from controversy over \$300 million in proposed state and local ERG grants to the Revel Casino in Atlantic City. A casino workers union and community groups were opposed to subsidizing construction of a new casino, believing it a bad investment of public dollars.[33] They pushed for a local public vote on the subsidies for the project. The sponsors of the 2009 ERG law wanted to ensure that a state ERG project could not be stopped by any local opposition. This new bill did just that. S-920 eliminated the right of a municipality to vote against a state ERG grant. It passed the Legislature on March 22, 2010 and was signed by Gov. Chris Christie on May 5, 2010.

Intent of the ERG Law

Some of the stated urgency from officials regarding the 2009 stimulus law was in response to the ongoing and vast national recession that began in 2007. A-4048 (Section 2c), described ERG and its other programs as short-term stimulus designed to help rescue New Jersey from the deep economic downturn:

The financial crisis has diminished the ability of the private sector to create economic development on its own. The world-wide drop in available capital along with a self-fulfilling drop in consumer confidence has created a downward spiral that can be overcome with the assistance of a partnership – a public-private partnership that targets tax cuts to drive economic development and job creation. Each of the facets of the law represents a direct response to the unique economic development challenges facing the State and local units.

Four months after the 2009 bill signing, the New Jersey Economic Development Authority, which has primary responsibility for administering ERG, released proposed administrative rules governing the program. By then, the public rationale for ERG appeared to have changed. The EDA memo accompanying the proposed rules said:

The ERG grant program is intended to provide a source of capital to developers and/or businesses or owners to reach full financing of the total costs of a proposed redevelopment project when additional capital cannot be raised from other sources.[34]

That sounds like a subsidy that could be applied in good economic times and bad. And, because each ERG deal can last for as long as 20 years, its impact will be felt in both good and bad times, well into the future.

Supporters of the ERG Law

Real estate developers were among the strongest proponents of the Economic Redevelopment and Growth Grant Program. Like the state's older tax increment financing laws, ERG was supported by developers looking for taxpayer support for their projects. At an October 2009 commercial real estate conference sponsored by developers, members of the Smart Growth Economic Development Coalition, an artfully named group formed by a dozen real estate trade associations, claimed the ERG law as one of its major legislative accomplishments.[35] The

Coalition includes the International Council of Shopping Centers, the New Jersey Apartment Association, the New Jersey Chapter of the Society of Office and Industrial Realtors, New Jersey-NAIOP and the New Jersey Builders Association.[36]

It is important to note some detail about the highly visible members of the developers coalition that pushed the ERG legislation. The International Council of Shopping Centers is the trade association for the retail real estate industry.[37] ICSC's members include shopping center owners, developers, managers and investors. The New Jersey Apartment Association is a statewide organization of apartment owners, managers and builders.[38] The Society of Office and Industrial Realtors is the professional association for realtors working in commercial real estate.[39] NAIOP-NJ represents the office, industrial and commercial real estate industry.[40] The New Jersey Builders Association is a trade association for the builders, remodelers, consultants, lending institutions and utilities in the housing and building fields.

Since ERG's passage, the Smart Growth Economic Development Coalition has gained new members that are not developers, including some trade unions and planning groups. However, as of January 2010, more than half of the member groups continue to be developers.[41] At that time, the coalition released a position paper with recommendations on economic development including that ERG be changed to include bonding by county or local governments instead of the current, less risky, pay-as-you-go reimbursement structure.[42] The coalition argues that the after-the-fact reimbursement in ERG – one of the most positive features of the program – is of "limited value" to

Case Study: East Rutherford

The newest state ERG grant may go to Xanadu, the $2.5 billion resort-type facility investors expected to open in 2007. In July 2010, a commission created by Governor Christie to "[advance or resolve] the stalled Xanadu project," among other things, concluded that "given the potential benefits to the state associated with completing the project … the state should cooperate in attempts to bring the project to completion" and that it be given an ERG grant to do so.[7] Although the report did not include specifics about the grant, newspapers reported that the grant would be for $180 million and would come from diverted sales taxes for as long as 20 years.[8] In addition to an ERG grant, the commission recommended the project receive Recovery Zone Facility bonds, federal stimulus dollars intended to foster economic development in distressed areas.[9] The development group already has a property tax abatement from the borough of East Rutherford.

Xanadu sits on a 104-acre site in the state-owned sports complex in the Meadowlands. When construction on the project began, developers planned a resort-type facility with a day spa, indoor ski jump, rollercoaster, minor-league baseball park and minimal retail space. However, since then, the project has experienced a number of financial challenges, causing construction on the project to stall. Most recently, developers said they hope Xanadu will be complete before New Jersey hosts the Super Bowl in 2014.[10]

Originally, retail was only to be a small component of the entire project – no more than 650,000 square feet in a 4.8 million-square-foot project. However, the retail component, which tends to pay significantly less and not provide health benefits to its employees, has grown to at least 1 million square feet.[11] The original proposal also included plans for 1.8 million square feet of office space that would be built during the project's second phase. Officials now say the office space is not likely to be built.

According to the commission's report, investors have already spent $2 billion on the project; another $875 million is needed, it said. Yet the first report on gaming, sports and entertainment completed by Christie's transition team only six months before, reported that $500 million was needed to complete the project.[12] Neither report included information on how the figure was determined. Public sentiment appears to be against the idea. A Fairleigh Dickinson PublicMind poll reported that 55 percent of polled voters believe giving state aid to the project is a bad idea; 20 percent believe it is a good idea.[13]

lenders.[43] Presumably, lenders want to see upfront public subsidy money since it would lower their required investment.

According to a piece on the coalition in *NJBiz*, the developers' group started meeting as early as the fall of 2007 with state legislators on key committees such as the Commerce and Economic Development Committees to discuss a package of bills targeted at, what the publication called, "real estate and economic development opportunities."[44] *NJBiz* reported that Senator Ray Lesniak worked closely with the coalition to draft the ERG bill. Senator Lesniak said, "I've gotten a lot of help from the coalition with regard to its expertise and garnering support in the Legislature." Discussing how four of the developers' 12-bill package was passed in late 2008 and 2009, Ted Zangari, founder of the coalition and a redevelopment attorney with Sills Cummis & Gross, said, "never in my wildest imagination did I think we would come so far in the span of one year."[45] Zangari said he thought asking for taxpayer support would be a daunting task given the state's shaky budget situation.

Getting Approved for an ERG Grant

Location, Location, Location

Before a developer files a single page of his state or local ERG application, he must first determine if the project is in a portion of a municipality eligible for ERG grants. Finding a location eligible for the grants is not hard – at least 80 percent of municipalities became eligible under the 2009 law. The law calls these ERG-eligible areas "qualifying economic redevelopment and growth grant incentive areas." These areas include certain portions of municipalities where economic development is encouraged under a collection of federal and state planning and economic development designations. However, these designations do not restrict ERG to economically struggling areas in need of redevelopment, rather allowing the subsidy to be used widely in the state — a bad policy choice.

To be an eligible location for ERG projects, a municipality must have one of three designations in the five Planning Areas – Metropolitan (Planning Area 1), Suburban (Planning Area 2) or a Center (in Planning Areas 3, 4 and 5) – in the State Development and Redevelopment Plan, more commonly known as the State Plan.[B] As their names imply, the Metropolitan and Suburban areas are the most densely populated and developed in the state. Centers are where economic development is encouraged in the more environmentally sensitive areas of the state.

Yet these are not the only areas where an ERG project can be located. Surprisingly, 15.4 percent of the Pinelands' 1.1 million acres is also eligible for ERG.[C] Although the Pinelands are widely thought of as only a preserved natural area, the Pinelands version of the State Plan – called the Pinelands Comprehensive Management Plan[D] – encourages economic development in certain places. Developers can get ERG grants for projects on up to 168,900 acres in these areas where development is encouraged.

ERGs can also be awarded in the six federal military bases closed under the US Base Closure and Realignment Commission. The former bases are in need of redevelopment. The six bases include Fort Monmouth in Eatontown and Military Ocean Terminal in Bayonne.[E]

Finally, local ERG grants can be given for projects built in state-designated Transit Villages. These are in municipalities with state-approved plans to redevelop the area around their transit facilities into compact, mixed-use neighborhoods that include a significant housing investment. Notably, Transit Villages are the only areas eligible to receive only local ERG grants; these cannot receive state ERG grants. New Jersey has 22 Transit Villages, including Montclair Township and Somerville Borough, which were added to the program in July 2010.[F]

The 80 percent estimate of ERG-eligible municipalities only includes the 451 eligible municipalities under the State Plan.[46]

B The State Plan is a plan for development and natural conservation for New Jersey municipalities statewide and puts parcels of land together based on factors such as population density, capacity of existing infrastructure, and existing natural systems.

C The Pinelands National Reserve was designated by Congress as the country's first national reserve in 1978. It sits on top of one of the country's largest aquifers – containing 17 trillion gallons of water.

D The Pinelands Comprehensive Management Plan delineates where development and conservation should occur in that vast natural area.

E US Environmental Protection Agency. Federal Facilities Restoration and Reuse: Base Realignment and Closure (BRAC) Sites by State/US Territory. October 3, 2008. http://www.epa.gov.fedfac/ff/bracstates2.htm.

F State of New Jersey. Department of Transportation. "NJDOT announces 'Transit Village' status for Montclair and Somerville: Participation in program boosts local redevelopment efforts near transit facilities." July 8, 2010. http://www.state.nj.us/transportation/about/press/2010/070810.shtm.

To avoid possible double counting or overlapping designations, the Pinelands, BRAC sites and Transit Villages are not included in this estimate of ERG-eligible areas, making 80 percent a conservative figure. Those 451 municipalities include 432 towns and cities with some area in either the Metropolitan or Suburban areas; and Centers. In addition, there are 19 municipalities that contain a Center but do not have area in the Metropolitan or Suburban designations.

Criteria Applied to State and Local ERGs

Both state and local ERG grants must meet certain eligibility criteria, while other criteria are described as important, but not required. In considering the grants, the Economic Development Authority, the Department of the Treasury and the Local Finance Board in the state Department of Community Affairs apply what are, essentially, hard and soft criteria to each grant.

The Economic Development Authority and the Department of the Treasury apply these hard criteria to state grants. EDA and the Department of Community Affairs apply these criteria to local grants. According to ERG rules, the hard criteria "must apply" to a project in order for it to be eligible for the program.[47]

The ERG rules also say that the head of EDA "shall consider" the essentially, soft criteria when deciding whether a state ERG should be approved. The Department of Community Affairs also must consider these soft criteria in deciding whether to approve a local ERG grant. However, a project would not be turned away for not fulfilling these soft criteria.

State ERG Approval

Under the previous tax increment financing law, the Local Finance Board in the Department of Community Affairs, which oversees municipal finances, approved TIF applications. Critics of the previous law said that the approval process through the Local Finance Board was too slow. Based on this criticism, a substantial portion of approval responsibilities for new grant applications was shifted to the Economic Development Authority under the ERG law. EDA was viewed as faster-moving and more accustomed to providing support for business.

On November 10, 2009, the EDA's Board approved rules for the ERG program, which EDA developed with the Treasurer, the Department of Community Affairs and the Attorney General's Office.[48] To get approved for a state ERG grant, a developer or business must apply to the Economic Development Authority. The EDA performs two analyses of each project – a fiscal

Hard Criteria Developers Must Meet to Get ERG Grants

- Project must be in an ERG-eligible area
- Project financing gap must exist
- Overall public assistance to the project must result in net benefits to the state and/or the municipality
- Developer himself must invest an amount equal to at least 20 percent of the project cost
- Combined state and local ERG grants cannot exceed 20 percent of the total project cost
- Developer of a new residential project getting a state ERG must reserve 20 percent of the units for low- and moderate-income households
- Developer can only get an ERG if construction has not yet begun, unless, EDA determines, "at its sole discretion," that the project would not be completed without the ERG grant. In the case of a project built in phases, only yet-to-be constructed phases can receive an ERG grant.

Source: New Jersey Economic Development Authority. ERG Grant Program Rules. November 2009.

Soft Criteria Considered in Examining ERG Grants for Developers

- Economic feasibility of the project
- Extent of economic and related social distress in the municipality and the area to be affected by the project
- Degree to which the project will advance State, regional and local development and planning strategies
- Likelihood that the project will be capable of generating new tax revenue in excess of the amount necessary to reimburse the developer for project costs outlined in the ERG agreement
- Relationship of the project to a comprehensive local development strategy, including other major projects in the municipality
- If ERG is needed for project viability
- Degree to which the project enhances and promotes job creation and economic development

Source: New Jersey Economic Development Authority. ERG Grant Program Rules. November 2009.

analysis and a net positive economic benefits test. The fiscal analysis evaluates the project costs and validates the project financing gap. This gap is the difference between the private financing the developer says is available and the cost of the project. The net positive economic benefits test looks at whether the total ERG subsidies to the project will result in net benefits to the state or municipality. The ERG rules say the net positive economic benefit must be equal to at least 110% of the amount of the grant.[49] After these analyses, the ERG grant is brought before the EDA Board for a vote. Once approved, the governor has 10 business days to sign or veto the board's monthly meeting minutes.

After a state ERG is approved by the EDA Board and governor, the EDA, along with the Treasurer enters into a "redevelopment incentive grant agreement" with the developer. The agreement specifies the terms of each TIF deal, such as the length of time for the TIF, the amount of the grant and the frequency of the payments.

In the first 13 months of the ERG program, seven state ERG grants and one local ERG grant have been proposed. Five of the state grants received approval. These are discussed as case studies throughout the paper. The one local ERG grant did not receive final approval.

Local ERG Approval

An ERG-eligible municipality must adopt a local law establishing a "local Economic Redevelopment and Growth Grant program" so that it can award local ERG grants to encourage development.[50] Once this law has been adopted, but before it can go into effect, it must be approved by the Local Finance Board in the state Department of Community Affairs.

A developer who wants local taxpayer subsidies for a project must apply for the ERG to the municipality where the project is to be located. The municipality grants preliminary approval of a local ERG by *introducing* an approving ordinance.

The ERG application is then submitted to the state EDA for the two required analyses. EDA does these analyses for both state and local grants. The process for local grants is identical to that used for a state grant. Once these analyses are complete, EDA's job is finished and the application is reviewed by the state Local Finance Board, which must vote to approve the application. Once the state review is complete, the municipality then grants final approval by *adoption* of the approving ordinance. Finally, the municipality executes an ERG agreement with the developer.

III. EVALUATING ERG: THE GOOD, THE BAD

The Good

The Economic Redevelopment and Growth Grant Program has some positive features that protect taxpayers and support important public purposes like affordable housing and providing jobs to workers on projects that pay a prevailing wage.

Case Study: Elizabeth

In February 2010, the Economic Development Authority approved a $7.9 million state ERG grant for the construction of a 189-room Embassy Suites hotel in an area of Elizabeth where there are already several extended stay lodging facilities. The nearly $40 million project is being built by Jersey Gardens Lodging Associates LLP, whose parent company is Sun Development and Management Company. The 20-year grant will come from the state share of hotel and motel taxes generated by the hotel.[14]

In its application to the state, Jersey Gardens Lodging claimed it lost its construction financing after the cost of building the hotel came in 30 percent higher than the developers originally expected. The availability of the ERG grant convinced the lender to allow the developer to borrow more. In addition to the $7.9 million ERG grant, Jersey Gardens Lodging will use $3.5 million in New Markets Tax Credits from the Elizabeth Development Company, a non-profit economic development company that works to help bring businesses and jobs to the city.[15] New Markets Tax Credits provide tax subsidies to investors in exchange for community development entities that invest in low-income areas.

- **ERG is a reimbursement program**. Taxpayers are not on the hook for upfront investments in projects that have not yet materialized. Revenues are only diverted after the developer's project is generating incremental tax revenue. This is far more financially prudent then paying out funds up front that leave taxpayers on the hook if a project fails. This is a positive feature of ERG and should be protected.

- **ERG limits taxpayer liability – to a degree.** The ERG subsidy cannot exceed 20 percent of the cost of the project, excluding the cost of publicly owned infrastructure. Also, developers are required to make an investment in the project equal to 20 percent of the project's total cost. These are important safeguards that have been built into ERG to protect taxpayers.

- **ERGs must be evaluated.** The fiscal analysis and net benefits test required of each ERG project are important safeguards for taxpayers. These analyses should provide a level playing field on which each grant application is considered, rather than a subjective award process which is a signature of many states' business subsidy programs.

- **ERG can increase affordable housing.** The requirement that new residential ERG projects reserve 20 percent of their units for low- or moderate-income households is a positive provision. The state needs more affordable housing and using a subsidy program to increase the supply of affordable housing is an important public purpose.

- **Property tax diversions are limited.** Property taxes are typically the only tax that can be diverted to tax increment financing projects in other states. In New Jersey, however, the property tax can be diverted only to a project in a redevelopment area where development already exists and the municipality has an actual overarching plan for redevelopment in place. This is a positive step by EDA and one that smart growth groups have supported.

- **Prevailing wages are required**. The requirement that prevailing wages be paid on jobs related to ERG projects is important given New Jersey's high cost of living.

The Bad

- **Far more revenues can be diverted to developers than before.** ERG allows 19 incremental revenues – eight state and 11 local – to be diverted. The previous TIF program, RAD, allowed 11 revenues to be diverted – one state and 10 local. RAD allowed up to 100 percent of the increment to be diverted, although a municipality could choose to divert less. Millville chose to divert only 50 percent to the RAD. Under ERG, up to 75 percent of eight state and 11 local taxes can be returned to the developer for up to 20 years.[G] Offering these 19 state and local revenues means New Jersey offers the most generous developer subsidy in the country in terms of the number of available revenues, according to Good Jobs First. These state and local revenues support state, county,

Case Study: Somerville

In May 2010, the New Jersey Economic Development Authority approved a $5 million state ERG grant for a Saker ShopRite to be built in Somerville.[16] The municipality has not had a supermarket in its boundaries since a Pathmark grocery store closed in October 2007.[17] The new ShopRite will be built on the site of the former Pathmark. According to the EDA, the ShopRite project is part of the municipality's redevelopment goals under its 2004 West Main Street Redevelopment Plan. The municipal plan calls specifically for a grocery store and the proposed ShopRite is supposed to serve as an anchor tenant.[18]

The ERG grant will divert $5 million in incremental state sales taxes and gross income taxes related to business income. Another $5 million in public funding for the project will come from a portion of the federal Recovery Zone Bonds allocated to Somerset County under the federal recovery act.[19]

G The 2009 ERG law lists 11 state taxes eligible, but closer examination indicates that three of those taxes were part of larger taxes also included in the law and should be accounted for as such -- hence, the decrease from 11 taxes to eight taxes.

Incremental revenues diverted under the New Jersey ERG finacing law.

Eight State Taxes Available for an ERG Project

- Gross income tax*
- Sales and use tax
- Corporation business tax
- Energy receipts taxes
- Tax on insurers generally
- Portion of the realty transfer tax
- Public utility excise tax on sewer and water corporations
- State hotel and motel occupancy tax

11 Local Taxes Available for an ERG Project

- Property taxes if it is redevelopment, not developing open space; must fall into the statutory categories of either "redevelopment" or "rehabilitation."**
- Payments in lieu of taxes under the long- and short-term property tax exemption laws.
- Portion of the sales and excise taxes in areas designated as PA1 in UEZs.
- Local hotel and motel taxes
- Payroll taxes (Newark Only)
- Lease payments made to the municipality by the developer or his successor
- Parking taxes from parking facilities located within the area
- Admissions and sales taxes from the operation of a public facility within the area
- Parking revenue from public parking facilities built as part of the project
- Tax on the rental of motor vehicles, regardless of whether the project is in the area where the tax is collected
- Upon approval from the state Local Finance Board, other incremental municipal revenues that may become available

* The portion of the state gross income tax available to an ERG is only that portion from business income passed through the personal income tax, not all income tax revenue.

** The targeting of the property tax only to redevelopment and rehabilitation took place in the EDA's proposed rules for the ERG program.

Source: New Jersey Economic Stimulus Act of 2009

municipal and school-level services. These ERGs will divert needed funds from services at every level of government.

- **Municipalities can lose Urban Enterprise Zone funds to developers.** The diversion of additional state sales taxes away from public services to retail businesses in 29 of the state's 32 Urban Enterprise Zones (UEZ) undercuts any possible value of UEZs. UEZs are areas within certain municipalities that are economically struggling. The UEZ program, enacted in 1983, benefits businesses locating in the zones by allowing retail businesses to charge customers only half of the state sales tax, among other tax benefits. One half of the current state 7 percent sales tax (3.5 percent) collected in the zones is returned in whole or in part to the local zone, not the state Treasury, for enhanced local services, infrastructure and economic development. According to a special report on the state's 32 UEZs in *NJBiz,* some projects that UEZ revenues have supported include additional police, local health services and grants to local business for façade improvements.[51]

Under New Jersey's previous tax increment financing law, businesses could get support from the halved state sales tax kept in the zone. Under ERG, with municipal and state approval, that benefit is expanded by allowing the full sales tax to be diverted for new projects in UEZs.[52] That sales tax would not go to the zone for local projects or to the state Treasury, but to private businesses. The only limit on this is that the business must be in a part of a UEZ that is also designated as an area of the state where economic development is most encouraged — the Metropolitan areas under the State Plan.[H]

A comparison of UEZ and State Plan data show that 28 of the state's 32 UEZs have significant acreage in Metropolitan areas, and thus would be eligible for this special sales tax benefit.[53] One well-known retail area that fits the criteria of being both a UEZ and Metropolitan area contains the Jersey Gardens Mall and Ikea Center in Elizabeth. New national chains could use land that is part of or adjoins those existing retail locations and be eligible to keep the entire 7 percent state sales tax. This special benefit has the potential of being a huge financial boon to large national retail chains, such as

H The UEZs that contain land in the Metropolitan area are: Asbury Park/Long Branch, Bayonne, Bridgeton, Camden, Carteret, East Orange, Elizabeth, Gloucester City, Guttenberg, Hillside, Irvington, Jersey City, Kearny, Millville/Vineland, New Brunswick, Newark, North Bergen, Orange, Passaic, Paterson, Perth Amboy, Phillipsburg, Plainfield, Pleasantville, Roselle Borough, Trenton, Union City, and West New York.

Wal-Mart or Target, which generate substantial sales tax revenue at each store. But subsidizing large retail establishments typically encourages low-wage permanent jobs without benefits.

- **Diverting the full 7 percent sales tax in a UEZ favors new retail over older established businesses.** While the full 7 percent sales tax would be available for new ERG retail projects, existing businesses applying for an ERG may only be eligible to benefit from the additional 3.5 percent sales tax – subject to municipal and state approval.[54] Presumably, the original 3.5 percent sales tax charged by existing businesses would be dispersed as in the past, however the state Economic Development Authority could not confirm this arrangement.[55] Presumably, that money would be sent to the local UEZ, in whole or in part, depending on the revenue sharing agreement in place with the state.

- **The revenue loss on these projects is up to 20 years.** The ERG law was passed as part of what was described as a short-term stimulus package for the state – something that would boost the state in the next few years. However, ERG is not structured as short-term stimulus, but as potentially long-term taxpayer support for developers. Such a long-term subsidy that drains money from the state, counties, municipalities and schools is financially irresponsible, especially without any annual independent evaluation requirement to determine if the program is benefitting the state overall.

- **The ERG law, unlike RAD, focuses on individual projects rather than wider redevelopment in a municipality.** The ERG law gives grants only for individual projects and improvements immediately related to that project. Focusing only on projects means the ERG program provides few opportunities for wider redevelopment in a municipality. Under the previous tax increment financing law, a geographic area of a municipality could be designated as a RAD where some projects generated additional taxes, as happened in Millville. In those cases, a portion of the taxes could be used to reimburse the developers as well as used to make improvements elsewhere in the district – a positive policy.

IV. BEST PRACTICES AND RECOMMENDATIONS

If ERG is used widely, the state, counties, municipalities and school districts will have significantly less revenue to meet an increased service demand from residents, businesses and visitors. The following best practices could turn this program into one that helps struggling municipalities finance needed

Case Study: Newark

The Halsey Street Teacher Village, a $124 million project officials hope will help revitalize downtown Newark, received a state ERG grant from the state Economic Development Authority in July 2010. Diverted state and corporate business taxes are expected to pay for the 20-year $20.5 million grant that will help build three charter schools, 221 apartments marketed to educators and several thousand square feet of ground-floor retail space.[20] An investment group, RBH-TRB Newark Holdings, has been formed to develop the project. The village received municipal approval in April 2010 and includes the construction of seven new buildings, rehabilitation of one building and demolition of eight mostly vacant buildings.[21] It is expected to create more than 900 jobs, including 466 permanent jobs and 450 temporary ones. The developer's application lists two of the three charter schools that will move to the facility; the third has not been identified. There are more charter schools in Newark than anywhere else in New Jersey.[22]

In addition to the $17.4 million ERG grant, the project has also received a $10.8 million grant from the state's Urban Transit Hub Tax Credit Program, $13.5 million in school construction bonds, a $4.3 million Revenue Allocation Bond (RAB) from the city of Newark and a $21.4 million New Markets Tax Credit from Goldman Sachs.[23] RABs are municipal bonds whose revenue stream will be used to support the capital costs of a project's infrastructure components. New Markets Tax Credits provide tax subsidies to investors in exchange for community development entities that invest in low-income areas.

improvements in their most distressed neighborhoods without overburdening them:

1. **ERGs should only be used for redevelopment in high poverty areas or areas with high unemployment as measured by quantitative standards.** Targeting ERG only to economically distressed municipalities would benefit the most vulnerable New Jersey residents by providing them with access to jobs and residential and commercial development.

2. **The ERG law should be amended to allow only the diversion of the non-school portion of the property tax like New York State, for an ERG grant. No state level taxes should be eligible for an ERG.** Twenty-nine states limit eligible tax revenue sources for TIFs to property tax.[56] Redevelopment is largely a local issue. Allowing state-level taxes to be diverted for local purposes to benefit private individuals has the potential to sap state resources that are critical to providing services to all New Jersey taxpayers. This has the effect of making everyone in New Jersey support development that benefits only a fraction of the population. Further, protecting the school portion of the property tax is vital given that revenues can be diverted for up to 20 years, thus draining needed funds from the state's schools over the long term.

3. **Every ERG project should be approved by the state, municipality, county and school district where it is to locate. All public stakeholders should meet as a single group to discuss and vote on ERG applications.** ERGs can divert tax revenue for up to 20 years from the state, municipalities, counties and schools, leaving them the burden of providing public services to more people with less money. If an ERG successfully attracts more residents – or even shoppers or workers – the cost of providing services increases.

   Utah requires local taxing entities affected by proposed tax increment plans to consent to the formation of the district. This has forced those proposing a TIF to justify their need to the affected tax districts. Often, this results in negotiation, either for the amount of time the property taxes should be set aside or for the local school district and county to share the money the district generates. Also in Utah, a committee is established to determine how long the redevelopment agency should collect the increment for and how the increment should be used.[57]

4. **The application process and subsequent implementation of all ERG grants should be transparent.** Information about each approved ERG project should be understandable and accessible on the internet. The EDA currently posts

Case Study: East Brunswick

In July 2010, Pagano Real Estate, a New Jersey-based developer, received a $3.09 million state ERG grant from the state Economic Development Authority to expand an existing shopping center on East Brunswick's Route 18 corridor. Plans for the 188,600 square-foot shopping center were approved by municipal officials in February 2008.[24] Since then, only 64,757 square feet have been built. That space is currently being leased to Babies "R" Us, which is new to East Brunswick, and Toys "R" Us, which moved from a township shopping center less than three miles away. The 20-year ERG grant will come from sales and corporate income taxes. Because ERG criteria prohibit grants from being given for existing phases of a project built in multiple phases, Pagano will not receive incremental taxes from either of the existing stores.

Pagano's application claims the additional stores would create 400 permanent jobs but says nothing about whether the jobs will be part-time or full-time, how much they will pay, and whether they will include health benefits. It also doesn't address the issue of whether these jobs are simply being moved from one shopping center in East Brunswick to another with no net increase in employment.

individual project data in spreadsheet form for its Business Employment Incentive Program (BEIP) and Business Retention and Relocation Assistance Grant (BRRAG) program – a positive practice. The information provided should include the location of the project, revenues diverted, grant amount, grant term, number of workers (construction and permanent) hired for or related to each project, how much those jobs pay and if the jobs include health and other benefits. To accomplish this, state and local agencies overseeing ERG programs should be given the capacity, including staff and funding, to collect and publish the information. Companies that do not comply with the reporting law should lose their ERG subsidies and be subject to stiff penalties.

5. **The governing body awarding the ERG should have the authority to recapture the money it has given if the developer reneges on his agreed on investment.** A company that receives an ERG grant should be responsible for paying back all of the money if it closes or moves out of state or for paying back a percentage of the money if it downsizes. EDA currently has recapture provisions in place for its BEIP and BRRAG programs. ERG includes no recapture provision.

6. **The ERG program should be amended to require an annual independent evaluation of projects to determine, among other things, whether they are creating jobs for residents and how much new tax revenue is being generated.** The new law currently has no annual evaluation requirement. Given the potential for the program to divert public funds for up to 20 years per project, regular evaluation of the program is necessary to protect taxpayers' investment.

7. **ERG should have a stronger affordable housing requirement**. Twenty percent of each ERG project's revenue should be placed in a dedicated fund to provide affordable housing. Currently, projects with newly constructed residential units must reserve at least 20 percent of the units for low- or moderate-income households. While that is a good step, every project should contribute toward funding affordable housing. This would not only help address the lack of affordable housing in New Jersey, but would also balance any reduction in affordable housing caused by ERG.[58] California and Utah both require 20 percent of the tax increment to be set aside for affordable housing. Portland, Oregon requires a 30 percent set-aside.

8. **Projects built using ERG revenue should be subject to agreements requiring living wages and give local residents first opportunity to apply for ERG-related jobs.** Projects that create a large number of construction or permanent jobs should establish training programs designed to qualify local workers for those jobs.

   New Jersey requires that developers receiving a state ERG pay a prevailing wage – a positive provision. This requirement should be extended to local ERGs. Other states have prevailing wage requirements. In Ohio, companies must pay prevailing wage if their projects have been supported by public money. This means that prevailing wage must be paid to workers on most construction projects, so long as the project exceeds a threshold amount and the type of project is not exempted by law.[59] Both Pennsylvania and West Virginia require that projects of more than $25,000 that are financed using TIF pay prevailing wage.[60]

CONCLUSION

Originally used as a tool to attract developers to blighted and poor areas, many states now use TIF in areas where it is not needed. New Jersey's new Economic Redevelopment and Growth Grant law puts New Jersey in that latter category by allowing developers to receive an ERG grant in at least 80 percent of the state's municipalities for up to 20 years with possible diversion of 19 state and local revenues.

Currently, the ERG law is not well-targeted to provide needed development in economically struggling areas. The law could be a much better tool for development if it focused on the parts of the state most in need of help.

Further, the ERG law is fiscally irresponsible, putting a long-term strain on the state, counties, municipalities and schools that they can ill-afford. Politicians and policy makers should think long and hard about the future of this state before they agree to forego public revenue to private developers. State revenues are at their lowest levels in years, local government resources are now capped at two percent for the foreseeable future and aid from the state to schools, municipalities and counties is declining. The only thing certain is that if the state gives away its resources with a broad brush, without careful analysis, the future will be bleak.

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New Jersey Policy Perspective

137 W. Hanover St., Trenton, NJ 08618

Phone 609-393-1145 • E-mail njpp@njpp.org

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