

New Jersey Smart Growth Tax Credit Overview

The Smart Growth Tax Credit is a new state legislative proposal that would create an incentive program to encourage developers to invest in appropriately located, energy-efficient residential and mixed-use construction projects that minimize land and water impacts, are pedestrian friendly, and facilitate the use of public transportation. In short, it is a tool to help the state grow in a smarter, more sustainable fashion. The proposed legislation defines criteria that projects must meet in order to qualify for the tax credit.

The program would provide a credit against state income taxes equal to a specified percentage of allowable costs (which would include the capitalized costs of construction but exclude the cost of land) for new and renovated buildings that meet the required criteria. Additional incentives would be available for those who redevelop brownfields, create mixed-use developments, include green buildings that are LEED™ certified, or take certain other measures that are not required. The applicant will contract with state-certified architects, engineers, or other third-party professionals to certify that the development meets program criteria—facilitating program administration and lowering the costs of implementation.

Smart Growth in New Jersey

Governor McGreevey's Smart Growth agenda includes proposals to restructure and redirect regulations, permitting, and infrastructure funding so that developers will be encouraged to build in and around existing urban areas. The Smart Growth Tax Credit is an ideal complement to these policy initiatives, because thus far they are intended to address mainly *where* development and infrastructure investment should happen, but not *what kind* of development should take place in these areas. The Smart Growth Tax Credit can function as the other half of this smart growth equation, encouraging developers not only to make the best location decisions, but to design compact, walkable neighborhoods close to transit, and to build homes and businesses that conserve water and use electricity efficiently. New Jersey is most likely to be successful in its efforts to change development patterns if it clearly defines what Smart Growth is, and creates limited incentives to help developers achieve it.

The tight budget situation that New Jersey currently faces makes the creation of a new tax credit program a challenge. However, the potential fiscal impact of the Smart Growth Tax Credit would be much smaller than might be assumed at first glance, and is more than outweighed by the economic and environmental benefits it can deliver to the state. For example, Smart Growth developments reduce the need for costly new infrastructure investments that new sprawling residential developments and office parks require. Researchers at Rutgers University recently reported that if the state did not build

transportation and water infrastructure that the current trend of sprawl development demands, it could accrue savings of \$2.32 billion. Although the creation of a Smart Growth Tax Credit is unprecedented, a recent analysis of Maryland's "Heritage Structure Rehabilitation Tax Credit" found that in 2000 and 2001, \$39 million worth of tax credits granted by the state spurred \$155 million worth of private investment in existing urban areas, and resulted in \$20 million *new* revenue for the state.

Any revenue reduction that might occur would be delayed until after implementing regulations are adopted (at least 12 months after passage of legislation) and the credits would be collected over a 5-year period following the completion of eligible developments. In addition, near-term impacts are partially offset by the increased taxes paid by residents of smart growth developments who enjoy greatly reduced energy bills and therefore higher taxable income levels. Finally, the total amount of tax credits available is explicitly capped in the legislation, so that the maximum possible impact to the state will be limited.

Policy Framework

The purpose of the Smart Growth Tax Credit is not to fund a handful of demonstration projects, but rather to create long-term changes in the market through a short-term incentive program. For that reason, the program is designed to expire after five years but to attract a large number of applicants within that time period.

We hope that the tax incentive will create a change in the market by encouraging a substantial number of developers and other building professionals to adopt cutting edge design practices and technologies more quickly than they might otherwise, recognizing that many market barriers prevent widespread adoption of even the smartest, most cost-effective measures to reduce the environmental and public health impacts of development. Introducing a new choice into the marketplace is likely to have higher transaction costs and risks than traditional development. Other barriers include higher first costs for certain technologies, lack of information about products and techniques, and limited human resources to devote to overcoming political and financing hurdles.

The Smart Growth Tax Credit is designed to create lasting changes in the market by helping building and development professionals permanently overcome many of these barriers and develop the capacity to create superior buildings and neighborhoods at minimal additional cost. We hope it will foster a new class of development with exceptional performance that will help demonstrate the benefits of—and the consumer demand for—environmentally superior development.

Statutory Criteria

In creating the substantive criteria that development would have to meet to qualify for the Smart Growth Tax Credit, we consulted a broad group of interested parties including members of the real estate industry, environmentalists, smart growth advocates, planners, architects, and engineers to help refine these criteria. We strove to identify practices, design strategies, technologies, and products that constitute substantial improvements over the current industry status quo, but that are achievable in the marketplace without undue risk. We also endeavored to design a tax credit that developers will actually use; we will have very little impact on the marketplace if we create a program that is too cumbersome, risky, or includes requirements that are not salable in the marketplace. We also recognize that the Smart Growth Tax Credit is not the appropriate tool to address all environmental, economic, and social issues related to development. We are trying to cull from the universe of Smart Growth practices those we can incorporate into a statutory framework.

In creating our criteria, we relied heavily on the following resources:

- NRDC's *Environmental Characteristics of Smart Growth Neighborhoods* (October, 2000).
- The New York State Green Building Tax Credit legislation, enacted in May 2000, and its adopted implementing regulations.
- The Vermont Built Green criteria for residential certification developed by Building for Social Responsibility (Vermont) and Vermont Energy Investment Corporation.
- The Leadership in Energy Efficiency and Design (LEED™) draft criteria for residential developments.

(All of these are available from NRDC upon request.)

Mechanics of the Credit Program

Developers would submit preliminary applications for eligible development to the New Jersey Department of Environmental Protection (DEP). Although we have developed a set of location criteria specifically for the purposes of the tax credit, the draft legislation has been amended to incorporate DEP's "BIG (Blueprint for Intelligent Growth) Map" project when it is finalized. DEP would issue certificates of location eligibility for the property in question, whether or not the applicant has purchased the property, if it meets the program's location criteria. Upon completion of the development, the applicant must obtain certification by a state-certified architect or engineer that the development meets the required criteria set forth in the legislation, and file it with the state when it claims the tax credit. In order to ensure that real estate investment trusts, non-profit organizations, municipalities, schools and governmental entities can participate in the program, tax credits would be freely assignable.

Lessons from Maryland

Governor McGreevey has pointed to Maryland's recent policy initiatives as the best example of state-level Smart Growth to follow. In addition to creating Priority Funding Areas, Maryland simultaneously initiated a dozen or so smaller programs that attacked the problems underlying sprawl from all directions: special mortgages for people who buy homes near their workplaces or in targeted areas of revitalization, conservation programs for farms and forests, historic preservation tax credits, grants to revitalize downtowns and neighborhood streetscaping, and others. The combination of these programs have helped demonstrate, to the public and to developers, what Smart Growth is and how it can be done—precisely what we believe the Smart Growth Tax Credit can accomplish.