LEGISLATIVE FISCAL ESTIMATE

[Fourth Reprint]

ASSEMBLY COMMITTEE SUBSTITUTE FOR

ASSEMBLY, No. 3680

STATE OF NEW JERSEY
215th LEGISLATURE

DATED: OCTOBER 9, 2013

SUMMARY

Synopsis: "The New Jersey Economic Opportunity Act of 2013."

Type of Impact: State and Local Revenue Impact

Agencies Affected: New Jersey Economic Development Authority (EDA), Municipal Governments

Office of Legislative Services Estimate

Fiscal Impact	Year 1	Year 2	Year 3
Local Revenue		Indeterminate – See comments below	
State Revenue		Indeterminate – See comments below	

- Under the Fourth Reprint of the Assembly Committee Substitute for Assembly Bill No. 3680 of 2013, the amount of tax credit activity under the Grow New Jersey Assistance (GROWNJ) and Economic Redevelopment and Growth Grant (ERG) programs is likely to exceed that of the existing five economic development assistance programs combined. The substitute is also likely to provide more generous tax incentives than the current programs provide.

- The Garden State Growth Zone (GSGZ) property valuation exemption will result in significantly reduced property tax revenues for the cities of Paterson, Passaic, Trenton, and Camden to encourage potential development which may not occur without GSGZ incentives.

- As development incentive award levels increase under the "New Jersey Economic Opportunity Act of 2013" (Economic Opportunity Act), business investment may be expected to grow substantially. While New Jersey Economic Development Authority (EDA) net benefits calculations require a financial benefit to the State before awarding incentives, the benefits test is a projection of future revenues, meaning that the actual revenues realized could be higher or lower than calculated by the net benefits test. Uncertainty about the magnitude of economic impacts from business investment and the resultant contribution to

State and local revenues makes the estimate of incremental tax revenues resulting from incentive awards granted under the Economic Opportunity Act indeterminate.

BILL DESCRIPTION

The Fourth Reprint of the Assembly Committee Substitute for Assembly Bill No. 3680 of 2013, entitled the "New Jersey Economic Opportunity Act of 2013," makes changes to various EDA economic development programs. The bill expands the Grow New Jersey Assistance Program (GROWNJ) and the Economic Redevelopment and Growth Grant Program (ERG), while phasing out the Business Retention and Relocation Assistance Grant Program (BRRAG), the Business Employment Incentive Program (BEIP), and the Urban Transit Hub Tax Credit Program (UTHTC), and creates a new Garden State Growth Zone (GSGZ). The expansions to GROWNJ and ERG incorporate various aspects of the programs phased out under the substitute. The objective of this consolidation of programs is to more effectively administer the State's premier economic development incentive programs, and to increase access to these programs for small to mid-size businesses.

Major changes made to the UTHTC include: (1) an expansion of the credit that can be taken in the next 20 tax periods from a $150 million limit on all credits to a $260 million limit on all credits against tax liabilities under the UTHTC; (2) the deadline for applications to UTHTC is shifted from July 1, 2014 to the effective date of the bill; (3) acute care medical facility projects may now qualify under UTHTC with lower minimum employment requirements; (4) $100 million of the $1.75 billion cap that was dedicated for offshore wind incentive awards has been removed from the cap, effectively providing another $100 million in capacity for GROW and UTHTC prior to the December 31, 2013 expiration of the cap and removing the expiration date for the $100 million in authorized offshore wind incentive awards.

GROWNJ is expanded to make businesses eligible for the program based upon the value of improvements per square foot of leasable space rather than a $20 million minimum investment. The program also reduces the requirement for the number of full time jobs created from 100 to a number between 10 and 50 depending on the type of industry. The value of the GROWNJ tax credits are increased from $5,000 per job, per year, for 10 years and $3,000 per job, per year, for 10 years in incentives for meeting certain conditions to a new base benefit of between $500 and $5,000 per job, per year, for up to 10 years with multiple new modifiers that would allow the base benefit to increase to between $2,000 and $15,000 per job per year. The total limits on project awards are $20 million or more with the limit being 100% or more of the base capital investment. Mega projects and GSGZ projects have no specified cap and GSGZ projects are able to set their credit per job at an amount equal to the capital investment divided by the number of jobs created, permitting the number of credits to grow above the initial incentive award amount if the number of jobs created is greater than the amount provided in the incentive agreement. The GROWNJ and UTHTC program are limited to a combined $1.75 billion in awards prior to December 31, 2013, after which time there will be no limit on awards under GROWNJ; however, the program will expire and cease accepting applications on July 1, 2018.

A cap on the amount of the State portion of tax credits that can be issued under ERG for qualified residential projects is established at $600 million, divided among projects in urban transit hubs, distressed municipalities, deep poverty pockets, disaster recovery projects, and economic redevelopment and growth incentive areas. There is no limit to credits that can be awarded under ERG for non-residential projects. The ERG credits are limited to 20% of any project's cost under current law, but may be expanded to up to 40% for certain types of projects and to close certain financing gaps. Municipal redevelopers are eligible for credits of between

75% and 100% of project costs. The State and local program is scheduled to expire and cease accepting applications on July 1, 2018.

The new GSGZ designation will increase the ERG and GROW awards for projects within the zones, while also making redevelopers eligible for an exemption from increased property assessments for areas that are redeveloped. Within a GSGZ, all improvements of any type will be exempt from increased assessments on improvements for at least 5 years; redevelopers that earn a profit of 12% or less on their investment will be eligible for a 20 year incentive that provides a full exemption for the first 10 years, followed by a 10 year phase in of the assessment at 10% per year.

Applications to the UTHTC will still be possible under the substitute within the $1.75 billion award cap, and the EDA shall have until December 31, 2013 to make final actions on the awards of project applications under the UTHTC before the program and the cap expire.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The Office of Legislative Services finds that it is not feasible to determine the fiscal impact of the substitute, the "New Jersey Economic Opportunity Act of 2013," however, the substitute is likely to result in a significant direct reduction in State revenue, relative to existing law, through the distribution of additional tax incentive awards to businesses and developers that invest in the State. These awards will incentivize economic activity which will bring in tax revenue equal to at least 110% of those credits, based upon EDA net benefits calculations. It is not clear how much of that revenue would be realized if those credits were not in place, nor is it clear what, if any, negative impact those credits will have on competing businesses in the State that do not receive these tax credits. It also is not clear what economic activity would happen in the absence of such tax credits, or the predictive accuracy of the net benefits calculation, resulting in an indeterminate State and local revenue impact.

Direct Revenue Reduction from Program Awards

The substitute will result in a direct reduction in tax collections by awarding various tax incentive awards in exchange for the retention or creation of jobs and real estate investment. The objective of these credits is to generate business activity in the State that would not happen if not for these incentives. The direct tax credit awards from impacted incentive programs under existing law are as follows:

Past Spending on Incentives Programs

Year	BRRAG - FY Total Award	BRRAG - FY Total Investment	BRRAG - FY Jobs	BEIP - FY Total Award	BEIP - FY Total Investment	BEIP - FY Jobs
2012	$ 72.9	$ 388.8	8,075	$ 71.9	$ 349.0	3,892
2011	$ 5.5	$ 127.8	2,476	$ 73.2	$ 165.5	3,632
2010	$ 3.6	$ 68.4	2,574	$ 152.5	$ 420.0	6,342
2009	$ 2.1	$ 40.8	1,508	$ 84.2	$ 227.9	3,712
2008	$ 6.1	$ 343.3	3,193	$ 133.4	$ 668.5	6,991

Year	ERG - CY Total Award	ERG - CY Total Investment	ERG - CY Jobs	GROW - CY Total Award	GROW - CY Total Investment	GROW - CY Jobs
2012	$ 104.6	$ 619.6	2,611	$ 391.6	$ 877.9	7,188
2011	$ 290.0	$ 1,768.7	5,967			
2010	$ 44.8	$ 256.8	797			
2009	$ 14.6	$ 81.3	1,600			
2008						

Year	UTHTC - Residential -CY Total Award	UTHTC - Residential -CY Total Investment	UTHTC - Residential -CY Jobs	UTHTC - Commercial - CY Total Award	UTHTC - Commercial - CY Total Investment	UTHTC - Commercial - CY Jobs
2012	$ 46.0	$ 222.0	46	$ 333.1	$ 664.8	3,586
2011	$ 42.0	$ 140.0	50	$ 301.0	$ 394.9	2,296
2010	$ 160.5	$ 591.4	654	$ 144.7	$ 255.6	1,205

note: UTHTC and GROW have awarded $1.41 billion of its $1.75 billion legislative limit for the life of the program.

Year	TOTAL Total Award	TOTAL Total Investment	TOTAL Jobs
2012	$ 1,020.1	$ 3,122.1	25,398
2011	$ 711.7	$ 2,596.9	14,421
2010	$ 506.1	$ 1,592.2	11,572
2009	$ 100.9	$ 350.0	6,820
2008	$ 139.5	$ 1,011.8	10,184

Note: FY = Fiscal Year; CY = Calendar Year

(Note: All dollar amounts provided are in millions)

The level of tax credits awarded under existing incentive programs has risen dramatically in recent years, from less than $200 million in 2008 and 2009, to over $1 billion in 2012. The only existing program with a strict appropriation limit is the combined GROWNJ and UTHTC, which is capped at $1.75 billion in incentives. While this rate of growth in awards might not continue, there is a clear trend of increasing utilization of these tax credit incentive programs for economic development. Under the substitute, the annual amount of tax credits awarded would likely remain above the $1 billion level reached in 2012.

The substitute increases the amount of tax credits awarded under GROWNJ and ERG resulting in higher award amounts for comparable projects than under the existing programs. In addition, by expanding eligibility to a wider pool of applicants, it is reasonable to expect greater participation and a greater amount of awards being granted under these programs.

The per job award limit was approximately $8,000 per job per year for 10 years through the GROWNJ program. Under the revised GROWNJ program, that job creation award rises to an amount up to $15,000 per job per year for 10 years, and within GSGZ areas the award is equal to the capital investment divided by the number of jobs created.

For example, there was a UTHTC award in 2011 for $102 million, 100% of project costs that was expected to retain or create 250 jobs. Under this bill, a similar project would seek assistance under GROWNJ. Under the new GROWNJ in a GSGZ, such a project would remain eligible for 100% of project costs based upon the capital investment ($102 million) divided by jobs (250), where the incentive award would be $408,000 per employee over 10 years, or $40,800 per employee per year, more than 500% higher than the award permissible under the previous

GROWNJ program, reflecting the expansion of the GROWNJ program and the way it replaces UTHTC.

The substitute places a limit on the residential project component of the ERG at $600 million. This places an upper limit on the amount that can be awarded for residential projects under that program. Given the rate of awards in 2011 and 2012, and considering the expansions made to the program with awards reaching 40% of costs in GSGZ, and that residential projects that would have formerly qualified for incentives under UTHTC will now be eligible under the expanded ERG program, it is likely that the full $600 million could be expended within two years.

While the available information indicates that applications for these programs and the size of awards will increase under the substitute, it is not possible to place an estimate on the amount of the aggregate increase because the decision about how much to grant under these programs is not predetermined. If the EDA were to limit the total amount awarded each year, the aggregate amount of award value could remain the same, while increasing the selectivity of the programs, and increasing the relative award size given a set amount of project investment or employment.

At the same time, given that under these programs companies are eligible for much higher incentive awards per dollar of investment or per job created than under existing law, it is not unreasonable to expect tax incentive awards to roughly double on a per job and per dollar of investment basis, despite the uncertainty of aggregate incentive award amounts. If the State is foregoing twice as much revenue per additional job or per additional dollar of investment, it is likely that the State's revenue return on incentives is likely to shrink substantially, negatively impacting revenues relative to current law. In order to make up for this reduced return on incentive dollars, the new incentives must either generate much higher quality investments and jobs through higher salaries and greater profitability and growth, or the incentives will have to generate enough additional jobs and investment to offset the reduced return on jobs and investment that could have been realized under the less generous programs, that would now further benefit from the enhanced programs.

Revenue Impacts Resulting from Program Awards

The business expansions that generally result from EDA programs increase State tax collections. Under GROWNJ, the tax incentive is equal to between $2,000 and $15,000 per full time job created per year for 10 years. While the amount of tax revenue is reduced relative to the program not existing at all, the State still realizes other taxes: 1) income taxes from the newly employed individuals; 2) business taxes remitted beyond the amount of the credits; 3) sales taxes from the sale of taxable goods; and 4) local real estate taxes on facilities where these employees work. The State also will realize additional revenues when the tax incentives expire, with GROWNJ recipients required to remain in the State for at least 1.5 times the length of their incentive, meaning full tax payments in years 10-15 after the incentives are awarded.

The tax credits awarded under the ERG can be between 20% and 40% of total project costs. These projects result in construction spending and employment while also creating jobs which result in additional income tax and increasing corporate taxes based upon the additional business activity created by the project.

For each award made by the EDA, a net benefits test is conducted which requires a project to generate a present value of at least 110% of the amount of assistance granted in the form of direct and indirect tax revenues from the project activity. Therefore, for every $1 billion in tax credits awarded, there should be at least $1.1 billion in tax revenue generated as a result of the project. Assuming that the State actually realizes the projections calculated in the net benefits test, the substitute would then be expected to generate a net revenue increase of at least 10% of the tax credits awarded under the ERG. If the substitute were to result in $1 billion in increased tax credit awards, the expected impact on State revenues would be an increase of at least $100 million based upon the net benefits test.

While the net benefits test provides a good estimate for the direct and indirect activity resulting from the investments made in order to obtain the credit, the test is not able to account for what would happen if the credit were not given in the first place. The test attempts to evaluate whether jobs in question are “at risk” of being eliminated or relocated; however, it is not possible to know the decision that a business would have made if the tax credit award was different or not offered. It is also not possible to know what activity would take place should a project not happen. For example, when a company leaves the State and leaves behind 100 unemployed persons and vacant property, the State will not experience a permanent reduction in revenue equal to all of the collections associated with that business. Eventually another use will be developed for the property and the unemployed State residents will eventually find new jobs or start new businesses of their own. If a supply of unemployed or underemployed skilled labor were to accumulate in the State, there would be a point at which new businesses would move in to fill that void, even without State tax incentives. At the same time, such levels of unemployment would also lead many individuals to relocate to other states with better job prospects, resulting in secondary impacts on the real estate market and property taxes as out-migration increases. The net revenue impact of losing a major employer is clearly negative, but not 100% of the revenue the employer previously generated.

The net benefits test also may not accurately project the second order impacts on markets and competing businesses that these tax incentives have on the economy, notably the economic and market impact caused by the arrival of new businesses with very favorable tax status. It is unclear what impact large tax incentives have on existing businesses, especially in situations where the new project results in direct competition with existing businesses. If a business moves into the State with a substantial tax incentive, it is realizing an artificially reduced cost of doing business relative to its in-State competitors. This can place existing businesses at a disadvantage so that the increased business activity and tax revenue for the incentivized businesses (lower tax rates) may reduce the business activity and profitability of existing local businesses (higher tax rates). That shift not only hurts existing business but also reduces government revenue by shifting business activity from higher tax rate payers to lower tax rate payers. The net benefit model does not appear to take into account these changes to the business marketplace that will happen as a result of newly incentivized businesses competing with existing businesses without such incentives. Providing large tax credits to businesses in an uneven manner across the State could impact the competitive marketplace in ways that cannot be easily predicted and calculated, even after the programs have been put in place.

One aspect of the programs that mitigates the impacts of this competition between local businesses is the restriction on retail business from qualifying for many incentives. Retail businesses generally compete directly with other local retailers. In situations where the businesses obtaining the tax incentives are competing nationally and internationally with businesses in other States and nations, the State impact is notably reduced, and may even generate greater net benefits due to the incentivized business having a comparative advantage over competitors in other States, resulting in business profits being further reinvested into the State economy. The benefit to New Jersey may be smaller than the loss for the competing State, but that would be a question of federal revenue impacts. These larger impacts on the economy are uncertain and provide a challenge to estimating the revenue impact of a tax incentive program relative to the revenue that would be realized in the absence of such a program. It is also a question that is somewhat outside the scope of a net benefits test as these second order impacts do not relate to the business itself, which has no responsibility for the health of competing businesses, and is not responsible for regulating markets. They are impacts more accurately attributed to the incentive programs themselves.

These questions of what would happen in the absence of the tax credits add a significant amount of uncertainty which is not directly addressed by a net benefits test. While it is likely the case that, under certain circumstances and certain situations, the tax credit programs generate significant net benefits to the State, there are also situations where the net benefit calculation determines that a project should be beneficial to a State; however, uncertainties created by the unique circumstances of that project can actually result in net revenue losses. For example, an electronics company can fulfill all of its commitments under the program by investing the agreed to amount in a facility and maintaining the required staffing and wage levels; however, a downturn in the global electronics market could result in lower profits and the company may not generate as much tax revenue as projected, despite a fixed incentive level based on employment.

A larger dilemma is that the bill requires net benefits calculations to occur over time frames larger than the commitment period under the incentive programs. For instance, net benefits are calculated over 30 years for mega projects and GSGZ projects under GROWNJ. The commitment period for GROWNJ is only for 15 years, meaning that a company can fully realize its incentives and fulfill all of its commitments after just 15 years. The net benefits test is required to assume that the company will remain for a full 30 years. If the company decides to relocate or close operations in years 15-30, the company will not be subject to any penalties under the program, but the net benefits assumed by the EDA will surely fail to be realized. If a project needs 20 years of full tax payments to be worthwhile for the State, but is only guaranteed to pay full taxes for 5 years, there is a chance that an incentive agreement could be executed as designed, yet still generate a significant net revenue loss for the State because the company chooses to relocate early.

Due to these uncertainties in what impact these programs have on the larger economy and related businesses, as well as the possibility that a company will relocate or close operations before the State fully realizes benefits from the incentive programs, there are downside risks that make net revenue losses under the program possible, despite a net benefits test.

The Office of Legislative Services finds that the revenue impact of the substitute is indeterminate with certain revenue losses due to tax incentive agreements which may or may not be fully offset by revenue increases from expanded business activity. The magnitude of the revenue losses from tax incentive agreements cannot be known because ERG and GROWNJ have no aggregate award cap from January 1, 2014 through the program expiration on July 1, 2018.

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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).