NEW JERSEY ECONOMIC DEVELOPMENT AUTHORITY

MEMORANDUM

TO: Members of the Authority

FROM: Tim Lizura, President and Chief Operating Officer

RE: NJEDA Economic Impact Model

DATE: December 13, 2016

Request

The purpose of this memo is to (1) request approval to revise certain assumptions and functionalities of the NJEDA's Economic Impact Model ("Net Benefit Model" or the "Model") and (2) ratify and approve as Authority policy our current practice of addressing corporate business tax ("CBT") in the Net Benefit Model. The Net Benefit Model is currently used for both the GROW NJ and Economic Redevelopment and Growth ("ERG") programs.

Summary Description of Model

The New Jersey Economic Development Authority (the "Authority") contracted the services of Jones Lange LaSalle ("JLL") to build an economic impact model to help measure the likely impact of a given development to the State of New Jersey (the "State") and/or its municipalities. On June 1, 2012, the Members of the EDA Board were provided with a memo which explained the theory and practical application of the Model that had been approved and implanted as of that date. For additional detail about the Net Benefit Model, please refer to the June 1, 2012 NJEDA Economic Impact Model memo attached.

The Model utilizes multipliers from the Regional Input-Output Modeling System ("RIMS II") data base, published by the US Department of Commerce, and JLL's econometric analysis and modeling to assess economic outputs, impacts and likely job creation. The Model is updated with new RIMS II data when new information is available. Also, adjustments are made to the Model when deemed necessary. In addition to economic information, the Model estimates the taxes from personal and corporate earnings that result from a certain project.

The Model estimates both direct and indirect impacts on a one-time and ongoing basis. Direct impacts are measurable benefits to the State caused by the capital flows of people and material directly associated with the project. Examples of direct impacts are payroll taxes generated from site workers' salaries and sales tax generated from the purchase of construction materials used in the project.

Indirect impacts are benefits to the State caused by economic activity by suppliers, employees, and other businesses as a result of the direct impact of the project. Indirect benefits are calculated based on historical statistical information captured in the RIMS II data. Examples of indirect impacts are taxes generated from the sale of local food vending establishments, equipment repair services, and local retail that have increased business due to the project. One-time (or non-recurring) benefits are those associated

with the project's capital investment. For instance, the sales tax generated from the sale of construction materials is a one-time benefit. Ongoing (or recurring) benefits are attributable to the project's annual economic activity. An example of an ongoing benefit is annual sales tax generated from a commercial tenant occupying space in a project site comprised of commercial development.

Note that one-time or ongoing benefits to the State may be either direct or indirect. The Model can provide unique analyses for office, retail, industrial, hotel and residential projects (although current incentive program statutes exclude the net benefit test for projects that are primarily residential) in each New Jersey county.

The primary user inputs of the Model include but are not limited to project location, total construction/project costs, property development type, size of project (based on square feet), and job categories. The inputs, and several optional inputs, are described in the "Primary Model User Inputs" section of the attached June 2012 Board memo. Based on these inputs, the Model calculates the likely impact on job creation, spillover economic activity (i.e., indirect economic activity), and earnings. However, whenever actual values are known, Authority staff can override the Model's estimates to use the known values rather than the formula driven results. Authority staff will choose the lower of the Model generated or applicant provided figure unless the applicant provides documented justification to do otherwise.

The RIMS II multipliers that are used provide a customized value of direct and indirect activity for each location, project type and job category.

State Economy Since the Implementation of The New Jersey Economic Opportunity Act of 2013

In response to the Great Recession, the State acted to reinvigorate New Jersey's economy and restore its economic health through the introduction of new tax increment financing and tax credit programs designed to spur development and redevelopment, encourage investment, and spur job creation and business growth. Since then, the economic circumstances in the State have changed; statistics and trends over the last year point to a positive economic recovery for New Jersey, which is expected to continue due to gains in the labor and housing markets.

The New Jersey Department of Labor and Workforce Development announced in November 2016 that private sector payroll employment has fully recovered from the last recession with 28,100 more people employed than during the pre-Recession peak. New Jersey has added 279,400 private sector jobs since February 2010, the recessionary low point for private sector employment in the State. While New Jersey's unemployment rate hit a high of 9.9% in 2010, it dropped to 5.2% in October 2016, according to preliminary estimates by the U.S. Bureau of Labor Statistics.[1]

Additionally, in July 2016, Lieutenant Governor Kim Guadagno announced the number of new businesses that filed to start operations in New Jersey last year was a record 97,835, the highest level in State history. In 2010, there were 80,773 new filings, according to the New Jersey Department of the Treasury.[2]

Further, professional services and investment management firm JLL announced in October 2016 that the overall vacancy rate in the Northern and Central New Jersey office markets declined to its lowest level

[1] https://lwd.state.nj.us/labor/lpa/pub/emppress/pressrelease/prelease.pdf
[2] http://nj.gov/governor/news/news/552016/approved/20160720a.html

since early 2009.[3] JLL also noted that industrial leasing velocity in Northern and Central New Jersey continued at a historic rate, particularly for Class A properties. Year-to-date net absorption reached 8.1 million square feet, putting New Jersey's industrial market on pace to record 10.0 million square feet of positive net absorption for the first time since 2001.[4]

Description of Changes to Net Benefit Model

At this time, Authority staff in collaboration with our consultant, JLL recommends certain revisions to the Model assumptions. The revisions as described below are intended to more accurately address scenarios observed over the years by Authority staff on applications seeking assistance under the ERG and GROW programs. Equally as important, Authority and NJ Treasury staff met on several occasions to discuss potential revisions to the Model that would better capture specific scenarios surrounding tax circumstances of individual tax payers and State UEZs. Finally, Authority staff engaged Rutgers University's Edward J. Bloustein School of Planning and Public Policy to complete a technical review of the Model and provide an opinion on how well it meets the EDA's goal of measuring the likely impact of a given development to the State of New Jersey and/or its municipalities.

Change in the Rate of Inflation Assumption

Currently the Model assumes a 20-year average inflation rate of 3.00%. This assumption will be updated to reflect the current 20-year average inflation rate of 2.25% per JLL.

Treatment of Direct and Indirect Benefits Beyond Applicant Commitment Period

As stated earlier, indirect impacts are measurable benefits to the State caused by suppliers, employees, and other businesses as a result of the direct impact of the project. Currently, the results of the direct and indirect ongoing annual tax calculation as described in the "State and Local Direct Ongoing" and "State Indirect Ongoing" sections of the attached June 2012 Board memo, are included at full value in the Model. The RIMS II multiplier used in the calculation of indirect annual spending is discounted by 100 basis points to ensure that direct spending is excluded before it is multiplied by the annual corporate spending. The values that are factored into the indirect ongoing taxes are annual corporate spending and annual payroll. As described in the "Total State Ongoing Net Benefits" section of the attached June 2012 Board memo, the direct and indirect ongoing annual tax results are combined and grown at annually at the rate of inflation and then discounted by 6.00% over the period of the net benefit analysis to obtain the net present value. A 6% discount rate is used as it reflects the standard measure for discounting the value of long term projects in economic impact models.

Authority staff recognizes that there is no statutory obligation for an applicant, under the GROW program, to remain in New Jersey beyond the required statutory commitment period. This required period commences at the Authority's acceptance of the project completion certification and ends after a term equal to 1.5 times the life of the award. Specifically, the maximum award period is 10 years, with a corresponding maximum commitment period of 15 years, yet the GROW statute requires the calculation of ongoing benefits over 20 years (and 30 to 35 for Garden State Growth Zones and Mega Projects). Moreover, the further out in time, particularly for a 30 and 35-year analysis, the less certainty exists with regard to the ongoing benefits.

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[3] http://www.us.jll.com/united-states/en-us/news/4273/surging-class-a-demand-pulls-northern-central-new-jersey-vacancy-rates-lower

[4] http://www.us.jll.com/united-states/en-us/news/4274/new-jersey-on-pace-to-record-10-msf-in-positive-net-absorption-in-2016?devicechannel=default

As such, and in light of the economic progress detailed above and in a effort to address the uncertainty in the later years of the net benefit test calculation, commencing in year 16 for the remaining term of the analysis period, the model will assume zero direct (corporate and employment) and indirect benefits. The model will continue to include 100% of the incremental property taxes that may have resulted from the project. If the applicant provides documentation satisfactory to Authority staff that they are committed to staying in NJ beyond the commitment period at the same employment and salary level, and are willing to document this commitment through an agreement with the Authority, the direct and indirect benefits will be included in the total net benefit calculation.

To explain, let's assume the analysis period of a certain project is 20 years. The Model will calculate direct and indirect ongoing annual taxes the same as it has historically been done. The Model will then increase these figures by 2.25% annually reflecting the revised inflation assumption. The direct and indirect ongoing annual taxes will continue to be discounted by 6.00% commencing in the second year of the analysis to determine the net present value of the future cash flows. Then, commencing in year 16, all of the direct (corporate and employment) and indirect benefits, excluding real estate taxes, will be zeroed out from the Model unless the applicant provides documentation satisfactory to Authority staff illustrating their commitment to stay in NJ for the remaining analysis period. This final net benefit figure will be compared to the calculated GROW or ERG award to ensure the 100% or 110% benefit, as the case may be, to the State threshold is met.

Pursuant to this approach, the Authority may be entitled to a future partial recoupment of a GROW award when the award would have been limited by the net benefit test, however, the applicant chooses to receive a higher award as supported by the statute, provided a longer commitment to remain in the State, and then subsequently violates this extended commitment in the future.

Potential Recoupment of GROW Award for Project Located in Garden State Growth Zone subject to the Municipal Rehabilitation Act (Camden)

In Camden, per the statute, the net benefit may be calculated based on 35 years and needs to be equal to at least 100% of the amount of the award. Let's assume a GROW award for a Camden based project if calculated on the basis of 15 years of net benefit (plus real estate taxes for 35 years) is limited by the total net benefit. The applicant has represented and provided documentation satisfactory to the Authority of its commitment to remain in NJ for a 20-year period. As such, the net benefit to the State and the award are based on a 20-year period, (plus real estate taxes for the entire 35-year period) and the award is increased. At this point the net benefit and the amount of the award are equivalent. The applicant, however, decides to relocate to another state in year 17; before the end of the 20-year analysis period. The Authority will be entitled to a partial recoupment of the award. The recoupment amount will be calculated at the time of approval and set forth in the Grow Agreement and equivalent to the amount the Grow award was increased based on the additional net benefit calculated for years 18-20.

Potential Recoupment of GROW Award for All Other Project Locations

On the same note, outside of Camden, per the statute, the net benefit is calculated 20 years (30 years for Garden State Growth Zone other than Camden and Mega Projects), and must equal at least 110% of the award. Let's assume a GROW award for a project if calculated on the basis of 15 years of net benefit (plus real estate taxes for the statutory period) is limited by the 110% net benefit test. The applicant has represented that it is committed to stay in the State for 20 years. As such, the net benefit including the corporate and employment activity are based on the full 20-year period. If the applicant decides to relocate to another state before the end of the 20-year analysis period, the Authority will be entitled to a partial recoupment of the award. The amount recouped will be calculated at the time of approval and set

forth in the Grow Agreement and equivalent to the amount the Grow award was increased based on the additional net benefit calculated for years 16-20.

This scenario is only applicable to GROW and not ERG, because the net benefit analysis in ERG is based on the actual number of years of the grant.

UEZ Impact

This revision will be more applicable for commercial ERG versus GROW projects.

Sales taxes generated by an ERG project, that is not a destination, and located in a non-UEZ does not produce new incremental tax revenue to the State.

So for instance, if total sales related to an ERG project, non-destination, in a non-UEZ was $1 million, the sales tax of $70,000 is generated. The model, however, does not include this figure in the net benefit because it is assumed these sales could have taken place either at this project location or any other non-UEZ location in the State. Thus, the tax revenues are not incremental.

If that same project were to be located in a UEZ, the sales tax is then based on 3.5% versus 7% and thus the tax revenue becomes $35,000.

Again, this amount is not counted toward the net benefit for the same reason the $70,000 tax revenue was excluded, however, in this case the State is getting $35,000 less in tax revenue since the project is located in a UEZ.

As such, the model will have as an assumption a negative 3.5% tax rate if the ERG project is located in a UEZ.

As recently enacted law has introduced a reduction in the sales tax, the net benefit analysis will be changed to reflect the reductions. Additionally, the Model will be revised to adjust to the various expiration dates of the States UEZs. As such, when a certain UEZ expires, the Model will no longer assume a negative 3.50% tax rate as explained above for projects located in that UEZ. The various sales tax rates will conform to the sales tax law as applicable over time.

Renovation Costs

The revised Model now includes two "Renovations Cost" input fields in the assumptions section. Renovation Costs is exclusive of Construction Costs. The title Construction Costs will replace the current input title of "Total Hard Costs". The first Renovation Cost field will be applicable for renovations deemed by Authority staff to be structural in nature and will result in a higher tax assessed value of a real property. The increased value will be used by the Model to compute the incremental property taxes that result from the improvements. The second Renovation Cost field will be applicable for renovations deemed not to be structural in nature by Authority staff thus having zero impact on the tax assessed value of a real property. Both Renovation Costs fields, however, will be used by the Model to calculate construction jobs and indirect benefits as was previously done for the "Total Hard Costs" input field.

This addition is warranted as the project costs of many applications seeking assistance under the GROW and ERG programs contained renovations that fell into one or both of the above renovation types. Authority staff during the underwriting process will review each project budget and confirm in writing with the applicant the nature of the renovations.

Gross Income Tax Progressive Scale

Currently, the Model calculates gross income tax by taking the salaries for each job classification and multiplying them by 4.00%, which is an approximation of the overall State effective tax rate. Authority staff will choose the lower of the Model generated or applicant provided figure unless the applicant provides documented justification to do otherwise. Refer to page six "Gross Income Tax" of the attached June 2012 board memo. The revised Model will base the gross income tax rate on the State's actual progressive scale versus 4.00% at all salary levels. This is accomplished by the incorporation of a table within the Model that accounts for the various statutory tax brackets and assumes a blended tax rate equal to the average of the married and single filing tax rates as published by the New Jersey Division of Taxation. The Model further assumes no dependents or deductions. The table is linked to the applicable user input fields of the Model that ultimately drive the final tax calculation. Such input fields will contain a list of all applicant salaries provided by the applicant to Authority staff. This improvement to the Model provides a better estimation of gross income tax.

New Jersey Earned Income Tax Credit (NJEITC)

NJEITC is a credit for certain residents who work and have earned income. The credit reduces the amount of New Jersey tax owed and may also provide a refund, even if there is no tax liability to New Jersey.

Most residents who are eligible and file for a Federal earned income credit can also receive a New Jersey earned income tax credit. For 2015, the NJEITC is 30% of the applicant's Federal earned income credit.

Incorporating the NJEITC into the Net Benefit Model provides a better estimation of income tax revenues generated by a certain project whose employees' salaries meet the income thresholds of the credit. This will be accomplished by the inclusion of a table within the Model that accounts for the various tax brackets, applicable NJEITC rates, and salaries of full time employees associated with the project. The Model will then calculate the credits based upon this information and deduct that total from income tax revenues.

Corporate Status/Corporate Business Tax Policy

Previously, the Model calculates its own corporate income tax by multiplying the number of jobs created by a profitability figure (pretax income) for the industry sector of the applicant and then multiplying that result by 9.00%. 9.00% was used in the Model to represent the average NJ corporate income tax rate. If the applicant provided a figure for the corporate income tax, Authority staff will choose the lower of the Model generated or applicant provided figure unless the applicant provides documented justification to do otherwise. Refer to page six "Corporate Income Tax" of the attached June 2012 board memo.

The Model has been made more accurate with a separate corporate tax rate of 9.00%, 4.00%, and 0% for "C", "S", and non-profit corporations respectively. A LLC would be treated either as a C or S depending on filing status. The tax rate used in the calculation depends upon the corporate status selected by the user via a drop down menu. This improvement to the Model has provided a more accurate estimation of corporate taxes as the figure is based on the applicant's corporate status versus a flat 9.00% assumption.

CBT is a component of the net benefit calculation. Currently, as described above, the model calculates an estimate CBT, and the Authority staff has the option to input an applicant provided amount. Authority staff has input a value of zero in some circumstances, such as with a non-profit or if the project would not result in incremental taxable income to the State.

The Model will default to zero CBT unless as a result of the project there is incremental taxable income in the State that would result in additional tax revenue.

Implementation of Model

This memo has been made available to the public via posting to the Authority's website. A public comment period will commence effective at the Authority's December 13th board meeting. The public comment period will end at the close of business on January 6th 2017.

Assuming all comments, if any, have been satisfactorily addressed, the revised Model will become effective on February 16, 2017 which is also the date of the Authority's February board meeting.

All ERG and GROW applications received on or after February 16, 2017 will be reviewed utilizing the revised Model.

ERG and GROW applications currently in-house or received prior to February 16, 2017 will be reviewed utilizing the current Model provided an approval is granted by the Members of the EDA Board before or on the Authority's June 13, 2017 board meeting.

Modifications to Approved Applications

Until the Authority's June 13, 2017 board meeting, should any GROW or ERG application approved for an award prior to the effective date of the revised Model require a modification that results in a 25% or more change in the project, the project will be reevaluated using the net benefit model effective at the time of original approval. All modification requests approved after the Authority's June 13, 2017 board meeting will be reevaluated utilizing the revised Model, as it may be amended from time to time.

Should any GROW or ERG application approved for an award after the effective date of the revised Model require a modification that results in a 25% or more change in the project, the project will be reevaluated using the revised Model, as it may be amended from time to time.

Timothy Lizura
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