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### MEMORANDUM

Initial Highlands Development Credit Price  
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#### Executive Summary

As described more fully below, the Highlands Council staff has conducted an analysis of developed residential lot values to determine the marginal value of increasing density from four units to the acre to five units to the acre. The results of this analysis reveal that adding the additional unit of density results in a regional lot value average of \$64,657.25 when adjusted for the fact that lots in an approved and improved condition were evaluated. This lot value is then reduced by 75% to account for a measure known as “developer’s willingness to pay.” When this deduction is applied, it results in an initial HDC price of \$16,000.

This analysis assumes that the value of HDCs will build over time as more opportunities to use credits arise. This assumption is based upon the experience of other TDR programs, such as the Pinelands Development Credit Program, which has seen credit prices rise dramatically as demand for credits increased. Given this assumption, it is critical to understand that the initial HDC price of \$16,000 is a *target*, which will only be achieved as demand for HDCs is created by establishing voluntary receiving zones and implementing other Regional Master Plan policies that will affect HDC demand.

#### Background

The Highlands Act TDR provision charges the Highlands Council with establishing the initial value of a development right. (N.J.S.A. 13:20-13.h) Establishing this price requires balancing two critical interests. First, the minimum Highlands Development Credit (HDC) price must be sufficient so that a sending zone property owner realizes an economic return from the sale of credit. Second, the minimum HDC price cannot be so great that it reduces a developer’s profit to such an extent that a proposed project is rendered uneconomical. Only by finding a balance between these two competing interests will an appropriate initial HDC price be established.

The dollar value of an HDC will depend on the profitability of the bonus density provisions for developers who construct in the voluntary receiving zones. (Nicholas 1982) A fundamental principle of the Highlands TDR Program is that, for each additional unit on a given lot, the increase

in revenues will be greater than the increase in costs. While costs savings are attributable to lower per unit infrastructure costs (streets, sidewalks, sewers, utilities, etc.) and other economies of scale, the principal source of savings is reduced land costs. (Id.) Consequently, residential and commercial land values per unit are a significant factor that will influence the value of HDCs.

Also important to the value of HDCs is the recognition that there is great variability in per unit land costs depending upon the particular end use of a lot. (Nicholas 1995) Residential land costs per unit differ greatly when comparing single family home development with that for townhouses or apartments. Similarly, commercial land costs per unit differ significantly between office, retail and other commercial uses. As one commentator explains, “all things being equal, the higher the permitted density (in the case of residential housing) or intensity (in the case of non-residential use) of a given lot, the lower the per unit land costs.” (Id.)

Understanding these concepts, staff has conducted an analysis to estimate the land value increments associated with higher density/intensity development. Staff then recommends an initial HDC price that attempts to satisfy the balancing of the two critical interests discussed above.

### **Initial HDC Price Analysis**

In an effort to determine the initial HDC value, staff analyzed 2005 MOD-IV tax assessment data of residentially developed parcels (Class 2) throughout the Highlands Region. This data set represents tax assessment information for January 10, 2004 through January 9, 2005.

Staff first segregated those Class 2 parcels that, based upon municipal zoning as of November 2005, could not be further subdivided. Using this refined data set, staff then separated out the parcels by their relevant density. The equalized assessed values of these parcels were then averaged for each municipality in the Region. The results of this work are detailed in **Appendix B** titled “Regional Zoning Factor,” which is discussed in the memorandum regarding the HDC allocation methods.

Using the data set developed for the Regional Zoning Factor analysis, staff then sought to predict the marginal value of a lot where density is increased from four units per acre to five units per acre. The basis for selecting this density interval is that the incentives for establishing a receiving zone under the Highlands Act are not triggered until the receiving zone has a minimum residential density of five units per acre for the residential portion of the receiving zone.

After plotting this data, four separate mathematical functions were used to predict the marginal value of the fifth unit per acre. The results of this work are represented in **Appendix A** titled “**Marginal Lot Value Analysis.**” The results of each function were evaluated based upon mean absolute error and a subjective determination of what functions visually yielded the “best fit.”

Using this information, staff selected the lowest lot value in a municipality with the best fit. The reason for selecting the lowest lot value is to prevent HDC values from being too high at the outset of the program and undermining any potential demand for the HDCs. The selected lot values are reflected in the column titled “Lowest Value w/ Best Fit” of Appendix B. Staff then reduced these values by 30% as these values reflect lots that are in an approved and improved condition. The reduced lot values were then averaged for the entire Highlands Region resulting in an average lot value of \$64,657.25.

Finally, staff applied an adjustment for a measure known as a “developer’s willingness to pay.” This measure was developed by Dr. James Nicholas, economics professor at the University of Florida, to reflect the fact that a developer’s willingness to purchase a TDR credit is the result of examining the economics between raw land costs, lot selling prices, and the cost/availability of infrastructure in the various receiving areas. When these three cost variables are significant developers have little money left over to purchase TDRs.

In assisting in the development of the Pinelands Development Credit program in the early 1980s, Dr. Nicholas applied a 50% adjustment to the marginal values resulting from his analysis. A similar 50% adjustment has been applied in other TDR programs, including the Long Island Pine Barrens credit program.

In establishing the initial HDC target price, staff applied a 75% adjustment to the regional average lot value. This was done to reflect the fact that receiving zones under the Highlands Program are voluntary. In the case of those programs where a 50% adjustment was applied, there are mandated receiving zones. The resulting target HDC price is \$16,164.31, which staff has rounded down to \$16,000.

### **Further Considerations**

Two further circumstances must be considered when determining the initial HDC price. First, in addition to the cost of an HDC, a developer may also be required to pay impact fees of up to \$15,000 per unit, provided that the municipality in which a receiving zone is located has met the Highlands Act’s minimum requirements for assessing impact fees and has adopted an impact fee ordinance. The cost of potential impact fees and HDC price relative to per unit approval and construction costs must be such that a developer still realizes a sufficient per unit profit.

Second, the Highlands Development Credit Bank, when established, will determine what amount it will pay per HDC to alleviate unique and extenuating financial circumstances. Importantly, the State TDR Act provisions under which the Highlands Development Credit Bank will operate do not place a limitation on the amount that the bank may pay to acquire HDCs. That said, the Highlands Development Credit Bank should be careful not to distort the operation of a private market by establishing a HDC price that is too high at the outset of the program. It is likely that the price paid by the Highlands Development Credit Bank after initial capitalization will establish a floor on HDC prices.