Highlands Transfer of Development Rights Program Overview

With the adoption of the Highlands Water Protection and Planning Act, P.L. 2004, c.120 (N.J.S.A. 13:20-1 et seq.) ("Highlands Act"), the State Legislature authorized the Highlands Council to establish a Highlands regional TDR program. The program is regional in scope and is premised on the resource assessment and smart growth component of the Highlands Regional Master Plan. (N.J.S.A. 13:20-13.a) It is also required to be consistent with the State TDR Act.

In addition to legal requirements imposed by the Highlands Act and the State TDR Act, the TDR program has been shaped by circumstances unique to the Highlands Region. One of the first considerations is the scale of the program. Although not the largest TDR program in terms of number of acres in which development potential can be transferred, the Highlands TDR Program will certainly involve the most number of municipalities. Within the region itself, there are 88 municipalities, but an additional 130 municipalities outside of the region may also serve as voluntary receiving zones. Consequently, a total of 218 municipalities may be involved in the program. By contrast, the New Jersey Pinelands Development Credit Program has 53 participating municipalities.

Given the geographic scope of the Highlands Region, another significant consideration is the widely varying real estate market values that exist across the seven counties. For example, vacant property in Warren County as of 2004 had an average equalized value of $15,452 per acre. In Bergen County, the comparable value was more than five times greater, averaging $84,964 per acre. Significant real estate market variability also exists among municipalities within a given county.

The last significant consideration is the fact that the designation of receiving zones in the Highlands TDR Program is strictly voluntary. The ability to develop with TDR credits in receiving zones establishes the demand for those credits. Consequently, it is necessary to establish adequate receiving zones for a private TDR market to be developed over time.

The framework for the Highlands TDR Program is established by the Regional Master Plan (RMP). It sets forth the areas that may serve as sending zones and receiving zones. It establishes the basis for allocation of Highlands Development Credit. It also mandates the creation of the Highlands Development Credit Bank. Each of these elements is described briefly, below.

Sending Zones

Under the RMP, all lands in the Preservation Area, except those located in the RMP's Existing Community Zone and approved Highlands Redevelopment Areas, are eligible to serve as sending zones. Additionally, upon conformance with the RMP, all lands within the Planning Area of a municipality, except those located in the Existing Community Zone and approved Highlands Redevelopment Areas, are be eligible to serves as sending zones as well.

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Receiving Zones

As discussed above, the Highlands Council is not authorized to mandate that municipalities designate receiving zones. Given this circumstance, the RMP establishes broad categories of areas that may serve as receiving zones, including:

- parcels of land located within the Existing Community Zone and any lands within a Highlands Redevelopment Area;
- parcels of land located in the Conservation Zone, provided that such receiving zones are consistent with the RMP and the development does not conflict with the maintenance of viable agriculture;
- parcels of land located within Highlands Counties but not within the boundaries of the Highlands Region, provided that the municipality has received plan endorsement in accordance with State Planning Commission guidelines; and
- parcels of land in a municipality within the Planning Area, which does not petition the Highlands Council for a determination of Plan Conformance, provided that the municipality has received plan endorsement in accordance with State Planning Commission guidelines.

The Regional Master Plan then sets forth a process for municipalities that wish to seek receiving zone designation for any lands that fall within the above categories. The process begins with a municipality conducting a feasibility assessment of the proposed area to accommodate the increase in residential density or non-residential use intensity contemplated by the municipality. Once the feasibility assessment is complete, the municipality must prepare a Petition for Receiving Zone Designation and include with that petition a resolution stating its desire to designate the proposed receiving zone. The petition must set forth the basis for the proposed Receiving Zone's inclusion in the Highlands TDR Program. The Highlands Council will then consider the municipality's Petition for Receiving Zone Designation and may approve the Petition for Receiving Zone Designation, provided that designating the proposed receiving zone is consistent with the provisions of the Highlands TDR Program and the Regional Master Plan. Upon Highlands Council approval of the Petition for Receiving Zone Designation, the municipality must then prepare a Transfer of Development Rights Ordinance to be reviewed and approved by the Highlands Council.

An essential aspect of the Highlands Act TDR provision is the incentives provided for municipalities that serve as voluntary receiving zones. The purpose of these incentives is to induce municipalities in the Planning Area, or municipalities outside the Highlands Region but within the seven Highlands counties, to voluntarily designate receiving zones in their communities. Municipalities become eligible for the incentives where they designate receiving zones which provide for a minimum residential density of five dwelling units per acre. The municipality must also be deemed in compliance with the Regional Master Plan if its lies within the Highlands Region, or have its certificate of eligibility for municipal master plan endorsement

approved by the State Planning Commission. Where these requirements are met, municipalities are eligible to receive the following incentives:

- The ability to charge up to $15,000 per unit impact fee for development projects within the voluntary receiving area;
- Up to $250,000 in an enhanced planning grant to offset the planning and other related costs of designating and accommodating voluntary receiving zones; and
- A grant to reimburse the reasonable costs of amending municipal development regulations to accommodate voluntary receiving zones.

Municipalities in the Planning Area that choose to conform to the Regional Master Plan are eligible for two additional incentives. First, they are entitled to legal representation by the State in challenges to municipal decisions regarding the voluntary receiving area. Second, they are to be accorded priority status for any State capital or infrastructure programs. Municipalities outside of the Planning Area are not eligible for these two incentives, but may be eligible for other incentives provided by the Highlands Council or those available under the State Development and Redevelopment Plan endorsement process administered by the Office of Smart Growth.

To encourage municipalities to explore the possibility of establishing voluntary receiving zones, the Highlands Council launched the TDR Receiving Zone Feasibility Grant Program in the spring of 2007. This grant program is designed to assist municipalities in assessing the potential for locating a receiving zone within their communities. Eligible municipalities, which need not be within the Highlands Region but must be in one of the seven Highlands counties (Bergen, Hunterdon, Morris, Passaic, Somerset, Sussex and Warren), receive both financial support (up to $25,000 initially) and technical assistance from the Council. Participation in the grant program requires a commitment by a municipality to fully evaluate the feasibility and desirability of designating a receiving zone, but does not obligate a municipality to establish such a zone. To date, eight municipalities have been awarded grants under the program while several others are currently preparing applications.

Highlands Development Credit Allocation

The RMP establishes two separate methods for allocating Highlands Development Credits (HDCs). The first method applies to those eligible parcels that are zoned for residential development; the second allocates credits to non-residentially zoned parcels.

Residentially Zoned Parcels

Within the vast Highlands Region, a development right in one county may vary significantly from the value of a development right in another. So, while assigning credits on a uniform basis, tied to the development potential of the land (soils, building constraints, underlying pre-Highlands zoning, etc.) is attractive for its simplicity, such an approach does not provide a

means to reflect the influence of varied markets on the value of credits. This creates inequities and it also creates a real market imbalance. In a TDR market where the value of a credit to a developer is the same wherever it is used, credit buyers will tend to seek out sending zone credits in lower land-value markets.

In light of this challenge, the Highlands Council developed an allocation of HDCs for residentially zoned property using a hybrid approach. Specifically, HDCs will be allocated on the basis of lost development potential but adjusted for relative differences in land value occasioned by property location (by municipality) and the type of development (underlying zoning) that could have been constructed onsite prior to enactment of the Highlands Act. Consequently, the formula for allocating HDCs to residentially zoned eligible parcels is expressed as: (Net Yield) x (Zoning Factor) x (Location Factor) = HDC Allocation.

For a residentially zoned parcel to be eligible to receive allocation consideration, it must meet one of three minimum thresholds. It must either:

- The parcel of land has an area of at least five (5) acres; or
- The area of the parcel of land is at least three (3) times the minimum lot size in effect on August 9, 2004; or
- The parcel of land is undeveloped and the owner voluntarily chooses not to develop the parcel pursuant to one or more of the exemptions under section 28 of the Act.

If a parcel of land does not satisfy one of the three above requirements, the parcel owner may request from the Highlands Council a determination of eligibility on a case by case basis based upon particularized extenuating circumstances.

Non-Residentially Zoned Parcels

The Highlands TDR Program also permits the allocation of HDCs to eligible, non-residentially zoned parcels located in the Protection and Conservation Zones. The basis for allowing such allocation is that non-residentially zoned parcels have fewer options than residentially zoned property for extracting equity out of these lands. Like the residential allocation method, the non-residential allocation formula incorporates the same elements, namely lost development potential adjusted for market conditions. Specifically, the non-residential formula accounts for the gross floor area of a non-residential building that could have been developed prior to passage of the Highlands Act and the underlying per square foot values of different types of non-residential development (office, industrial, retail). This allocation method is expressed in the following formula: (Permitted Square Footage) ÷ (Non-Residential SF for Specified Use) = HDC Allocation.

Initial HDC Price

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 HDC price must be sufficient so that a Sending Zone landowner 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.

Based upon an assessment of regional lot values, the Highlands Council established the initial HDC price of $16,000 per credit. For more detailed information regarding the analysis the Highlands Council conducted to arrive at this initial credit price, please see the TDR Technical Report at http://www.highlands.state.nj.us/njhighlands/master/tr_tdr.pdf Please also keep in mind that as the private market for HDCs is established, it is believed, based upon the experience of the Pinelands Development Credit Program and other regional TDR programs, this per credit price will vary over time.

Highlands Development Credit Bank

Recognizing the important roles that a development transfer bank plays in implementing and administering a TDR program, the Highlands Council adopted goals, policies and objectives in the RMP to establish a TDR bank called the Highlands Development Credit (HDC) Bank. As envisioned in the RMP, the HDC Bank serves as (i) a regional clearinghouse for information with regard to the Highlands TDR Program; (ii) the administrator and official recording agency for the Highlands TDR Program; and (iii) a buyer and seller of Highlands Development Credits.

The Highlands Council established the HDC Bank by resolution on June 26, 2008. The Chairman of the Highlands Council appointed the members of the HDC Bank Board of Directors and the Bank held its first meeting in February 2009. The Directors adopted by laws and the Bank's operating procedures, which govern the day-to-day activities of the Bank.

The HDC Bank has also adopted a resolution approving its initial HDC Purchase Program. Under the terms of this resolution, the HDC Bank will seek to purchase credits from property owners who are able to demonstrate an extenuating financial circumstance where:

1. The owner's equity in the land to which the HDCs are allocated is substantial in relation to the owner's net worth; and
2. The owner is experiencing extraordinary financial hardship, including but not limited to imminent bankruptcy, extraordinary medical expenses, or loss of job.

The initial HDC Purchase Program is scheduled to begin in January 2010 or upon the release of HDC Bank appropriated funds from the New Jersey Treasury Department, whichever is later.