



IO SERVICE REPORT

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INTRODUCTION TO INFRASTRUCTURE FINANCING

In this report on infrastructure funding options, more than 20 funding sources or mechanisms are discussed, including bonds, impact fees, user charges, and special districts. Each source is described and discussed in terms of the type of project for which it is suited, its advantages, its disadvantages, and examples of implementation. The text highlights basic differences between funding options as well as the trade-offs that local governments must consider.

Examples taken from local government practice illustrate the discussion of each funding option. Because laws and circumstances vary from community to community, readers will want to consult with financial and legal experts to learn more about specific financing details, legal issues, and other concerns involved in implementation of any of these options.



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Introduction to Infrastructure Financing

Paul Tischler has over 25 years of fiscal and economic consulting experience. As principal of Tischler & Associates, Inc., he has worked on more than 400 impact fee assignments, 300 fiscal impact evaluations, and many revenue strategies. Tischler & Associates, based in Bethesda, Maryland, focuses on fiscal evaluations and revenue sources and strategies. Dwayne Guthrie has more than 18 years of relevant fiscal and economic experience. His revenue evaluations include utilities as well as virtually all other public sector activities in which infrastructure is involved. His consulting assignments include clients located throughout the United States. Nadejda Mishkovsky, an intern with Tischler & Associates, provided research for this IQ report.

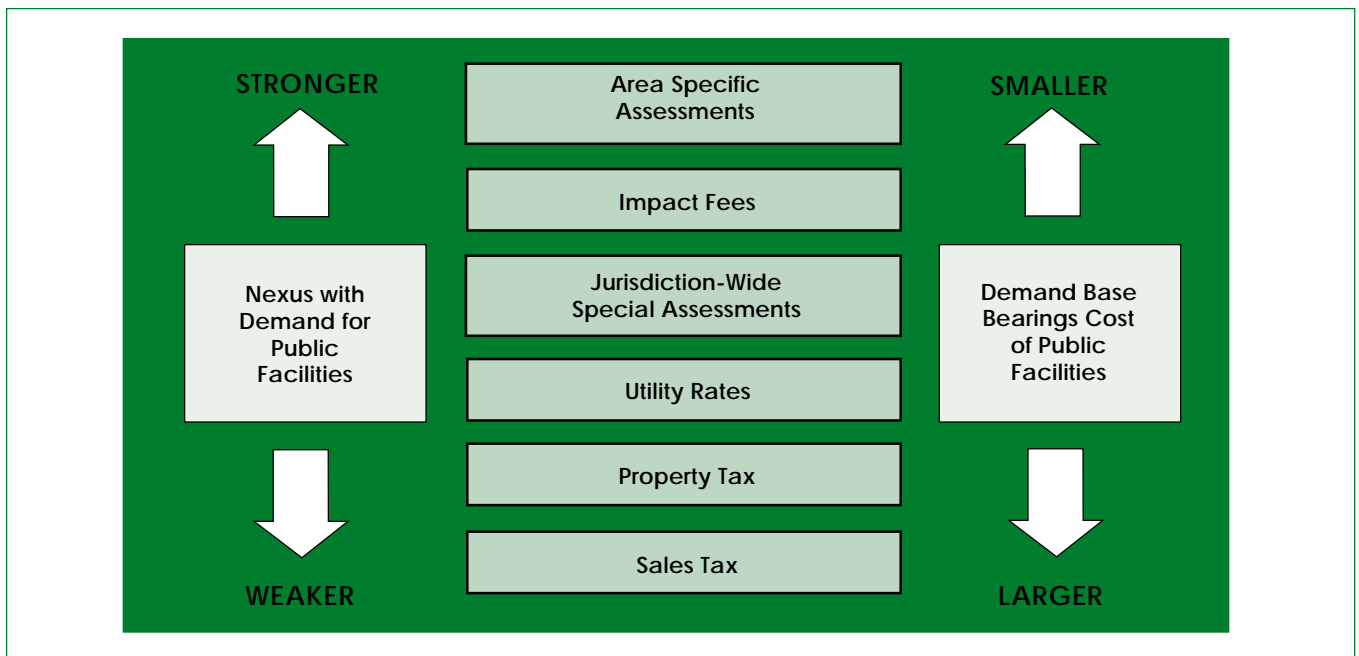
INFRASTRUCTURE FUNDING CONSIDERATIONS

Infrastructure funding alternatives force decision-makers to wrestle with the dynamic tension between two competing desires. As shown on the left side of Exhibit 1, various funding options have a strong to weak connection between the source of funds and the demand for public facilities. The funding sources with strongest connection to the demand for public facilities include area-specific assessments and impact fees. Funding sources with the weakest nexus include sales and property taxes.

Unfortunately, the funding options that offer the closest nexus with the demand for public facilities also have the smallest demand base to bear the cost

of the public facilities (see the right side of Exhibit 1). The smallest revenue base for funding capital improvements is the area-specific assessment. For impact fees, the revenue base may vary by geographic service areas, or may include all development within a jurisdiction. But even if impact fees are collected from all new development in a jurisdiction, the magnitude of the fees collected depends on the annual increase in development. In contrast, sales tax revenue is collected from a large revenue base that may in fact be larger than the jurisdiction that is collecting the fees. For example, a jurisdiction may serve as the commercial center of a large, regional market area. In this case, the sales tax collections are based on the buying power of the region.

Exhibit 1 Funding Sources by Demand and Size of Funding Base



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The difficulty in selecting the best infrastructure funding strategy is illustrated by the following scenario. If a developed neighborhood lacks sanitary sewer service, an area-specific assessment could be used to install local sewer lines, with the cost of the project paid by property owners in the neighborhood. However, installing sewer lines in an existing neighborhood could cost several thousand dollars per house. Given the magnitude of the financial burden, elected officials usually turn to a larger revenue base, such as utility rates or sales tax revenue, to help fund this type of project.

Although the circumstances are different, local officials must address the same type of issues when selecting funding alternatives for new development areas. Even though impact fees are based on a rational nexus (geographic benefit) to the demand for public facilities, they may conflict with economic development and affordable housing goals. Elected officials have to balance these concerns with the common desire of current residents to minimize utility rates and property taxes.

Exhibit 2 ranks various criteria that may be used to evaluate options for funding infrastructure. The ranking of criteria from negative to positive is based on general conditions that may not be applicable in a specific jurisdiction. For example, some states have enabling legislation on special districts that may establish assessment methodologies or other requirements that make them impractical.

The column headings across the top of the evaluation matrix represent just four possible ways to compare various infrastructure funding alternatives. The ranking of “technical ease” is based on the general perspective of public sector managers. Both special districts and impact fees have been given a negative ranking because they often require consultants to provide legal or technical expertise. However, the cost of professional services is often added to the capital cost of infrastructure and can be recovered through implementation of the new funding mechanism.

Public acceptance of infrastructure funding proposals may also vary by jurisdiction and the type of facility to be constructed. For example, bonds have been given a negative ranking because they often require voter approval. The public relations campaign to obtain approval may require significant time and money. However, in growth communities that do not have a large base of retirees, bonds for new schools may easily gain voter approval.

SEVEN COMMON REVENUE SOURCES

Seven types of tax revenues—property tax, local option sales tax, income tax, special tax, gas tax, real estate transfer tax, and excise tax—are commonly used to fund operating as well as infrastructure cost and are so well known that we will discuss them only briefly.

Property Tax

The primary source of revenue for most local governments is the property tax. Many states, including California, Colorado, and Arizona, have severely limited property taxes. State law may actually control how a local government raises money and/or the allowable percentage increase. Tax values are calculated by multiplying the assessed property value by the tax rate. Property tax revenues are commonly used to fund infrastructure other than utilities (e.g., police, fire, streets, and general government buildings). Property tax valuation is also applied in special districts, special assessment districts, and municipal service districts, described later in this report.

The property tax is a relatively stable source of revenue with predictable, potentially large yields and limited problems of taxpayer avoidance. Other benefits include its progressive character; its tax-deductible status on federal income tax returns, and the public’s familiarity with the use of property tax revenue for public safety and other infrastructure related to real property, such as roads. However, the property tax increases the cost of housing and may affect business investment in real estate. Some may argue that increasing tax assessments creates a disincentive to improve property.

Local Option Sales Tax

The local option sales tax adds a voter-approved tax to the purchase price of goods. Exemptions can be used to lessen the regressive effect of this tax for some qualifying customers or types of purchases such as food and medicine. Often the most convenient and politically acceptable form of infrastructure financing, a sales tax is generally easy to administer and relatively invisible when it is “piggy backed” onto state taxes. A sales tax is one way to generate local revenue, especially in states that restrict property taxes. Finally, a sales tax broadens the tax base to include non-residents.

A sales tax can be considered a regressive tax, especially if it is applied to groceries, since lower-income households spend a greater share of their income on groceries than upper-income households. A sales tax may threaten local businesses if sales taxes throughout the region are not uniform, because shoppers may decide to purchase goods in nearby jurisdictions where sales tax rates are lower. Finally, sales tax revenues vary with spending trends, and so are less reliable than property tax revenues.

Income Tax

The local income tax is levied against income. The revenues from a local income tax depend on the breadth of the tax base and the tax rate. Income tax revenues are more susceptible to economic swings

Exhibit 2 A Ranking of Funding Sources

	Revenue Potential	Technical Ease	Proportionate to Demand	Public Acceptance
Bonds	positive	negative	negative	negative
Special Districts	negative	negative	positive	positive
Developer Exactions	negative	neutral	negative	positive
Impact Fees	positive	negative	positive	positive
Excise Taxes	positive	neutral	negative	positive
Property/Sales Tax	positive	positive	negative	negative
Transfer Tax	positive	positive	negative	neutral
User Charges	positive	positive	negative	negative

than property tax revenues. For this reason, dependence on an income tax for funding infrastructure is not advisable. A local income tax, like a property tax, is deductible from the federal income tax. Income taxes can be levied based on place of residence (as in Maryland) or of employment (as in Ohio).

Special Purpose Tax

Although restricted by state authority, local governments may be able to levy special taxes to fund specific purposes. Hotel/motel occupancy taxes and vehicle licensing taxes are special purpose taxes. For example, hotel/motel taxes are frequently used for tourism development activities while vehicle licensing taxes are used to cover the cost of keeping motor vehicle records. Like user fees, special taxes may be politically successful because they are restricted to a specific purpose. Special taxes can be used to pay the interest on bonds. They may also be paid by non-residents. Although a local referendum may be required, the special purpose tax is becoming an increasingly popular funding resource for special facilities such as arenas.

Gas Tax

The gas tax is a form of special purpose tax that is imposed on the price of gasoline. Revenues are usually dedicated to road construction and maintenance, benefiting those who pay the tax. Fuel taxes are usually administered by the state.

Excise Tax

Similar to impact fees, excise taxes are often used for new infrastructure and services demanded by the new construction. Local excise taxes generally originate at the state level, although several states permit cities to use them. California, Colorado, Maryland, and Arizona allow cities and counties to impose excise taxes on new construction. Since they are taxes, the jurisdiction has more discretion in their use than is true for fees such as impact fees. For example, although imposed on new development, excise taxes differ from impact fees in that they do not have to provide 100 percent direct benefit to the new development.

Real Estate Transfer Tax

Also known as a deed transfer tax, a real estate transfer tax is a tax on the transfer, sale, or conveyance of real property. The rate is applied against the price of the property. The use of revenues raised can be restricted to growth-related capital costs. For example, Maryland authorized a real estate transfer tax, with a specific percentage set aside for the purchase of parkland.

BONDS

The previous section briefly discussed seven common revenue sources. This section introduces two

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common financing mechanisms: general obligation (GO) bonds and revenue bonds. If a jurisdiction is not paying cash for infrastructure (pay as you go), it is probably going to first consider GO or revenue bonds. Most GO bonds are securitized by property taxes and other general fund revenues. Accordingly, they are backed by the “full faith and credit” of the jurisdiction. More than 90 percent of all jurisdictions use GO bonds to raise money.

Since revenue bonds are not as prevalent, the remaining discussion will focus on these debt instruments. Revenue bonds are usually a desirable method to finance new infrastructure because the debt is retired with revenues received from the users of the improved facility. These bonds are backed by revenues from sources more specifically defined than those backing GO bonds. The sources, most of which are discussed in subsequent sections, can be an income tax, user charges, an assessment district, a special tax district, or, in some cases, impact fees. A local jurisdiction may issue revenue bonds without voter approval, which is required for most GO bonds. Since dedicated revenue streams are less predictable and less stable than total general revenues, interest rates may be higher for revenue bonds than for GO bonds, to offset the bondholder’s increased risk.

Appropriate projects. Revenue bonds are best used when a specific revenue source can be easily identified, such as an assessment district or a utility user charge.

Advantages.

- Revenue bonds may not affect the debt capacity of the jurisdiction since they are not backed by the full faith and credit of the issuing locality.
- Revenue bonds do not require voter approval.

Disadvantages.

- Revenue bonds may be more costly to a locality than general obligation bonds, unless the revenue source is broad based (e.g., utility fees) since the bonds are not backed by the full faith and credit of the jurisdiction. However, a utility district that has sufficient revenues (one and a half to two times the amount of the bond payments) and also provides its full faith and credit may get the same interest rate for a revenue bond issue as it would for a GO bond issue because of the “double barrel” revenue and guarantee features.

Examples. Revenue bonds are frequently used to fund utility operations. As an example of their importance in municipal finance, at the end of fiscal year 1997, the bonded debt outstanding for the city of Philadelphia was \$586.70 million in general obligation (GO) bonds, and \$2,739.42 million in revenue

bonds. The 82 percent of the debt comprised by revenue bonds included bonds for water and sewer (56 percent), gas works (27 percent), and aviation (16 percent).

Terms for revenue bonds usually range from 10 to 20 years. They are likely to have a slightly higher interest rate than GO bonds, perhaps 1/8 to 1/4 of a percent higher.

SPECIFIC PURPOSE REVENUES AND FINANCING MECHANISMS

This section discusses both specific purpose revenues as well as financing mechanisms. The categories are: user charges, stormwater and transportation utilities, congestion pricing and tolls, lease-purchase contracts and certificates of participation, special assessment districts, business improvement districts, special taxing districts, utility districts, and tax increment financing.

User Charges

Similar to pricing for privately produced goods and services, user charges can be an efficient means of paying for operating expenses and maintaining facilities, and to retire revenue bonds used to finance construction. User charges recover costs for services provided by the local jurisdiction, such as water, electricity or gas, and recreation.

Charges can be structured in a variety of ways. In the case of metered water use, fees are tied to the level of use; residential garbage collection is generally based on a flat monthly fee. User charges are permitted by the locality’s police power (its authority to protect and promote health, safety, and the general welfare).

Appropriate projects. User charges are most appropriate when the service provided is easily identified and the amount of use can generate sufficient revenues. Any capital project benefiting the users could appropriately be financed with user fees. Examples include sewage collection lines or a water treatment plant. However, since user charges can also support operating expenses, it may not be desirable to earmark them for a specific capital project.

Advantages.

- User charges allow capital expenditures outside normal tax or spending limits and are bondable.
- Users pay for what they consume, and are thus encouraged to limit their consumption of resources.
- With user charges, consumers of the service see a direct relationship between benefits and charges.
- By permitting agencies to be self-supporting, user charges promote administrative efficiency.

- User charges allow the jurisdiction to avoid general tax increases.
- User charges can be applied to a broad range of expenditures in existing, emerging, and new locations.
- User charges may be practical for less costly improvements, where bond issuance may not be cost-effective.

Disadvantages.

- User charges can be considered inequitable when set without regard to marginal cost differences for users and geographic areas.
- User charges are not voted on.
- User charges are not deductible from income taxes (while property taxes are).

Examples. It is common for at least two-thirds of a utility's revenues to be generated by user charges in the form of rates. For example, the Metropolitan St. Louis Sewer District (MSD) is an independent public agency responsible for sewers, sewage treatment, and storm drainage from 524 square miles of the city of St. Louis and St. Louis County, Missouri. Of \$193.7 million in total revenues collected by the MSD, user charges provide \$126.3 million, or 65.2 percent.

Stormwater and Transportation Utilities

Potable water and sanitary sewer utilities are closed systems in that the provider has control over when and where customers are added. The sewer and water operations are usually enterprise funds within the municipality or separate utility districts (discussed below under utility districts). In recent years, local governments have expanded the utility concept to more open systems like stormwater and transportation facilities. The stormwater utility concept is likely to grow as the costs of controlling stormwater increase without commensurate growth in general fund revenues.

With a stormwater utility, the fees can be added to the sewer or water bill. User charges are assessed to those who increase the need for, or who benefit from, the improvements. Collection may be annual or monthly. The steady revenue stream can pay for construction, maintenance, operations, and related administrative costs. This additional source of revenue can also improve a local government's ability to bond infrastructure improvements. Utility fees are not subject to voter approval. However, one-time or "connection" fees should follow rational nexus requirements. The administration of an additional utility results in some overhead costs. Also, the laws in each state must be examined for basic legal guidelines, since utilities for stormwater and roads are relatively new funding mechanisms.

Municipal stormwater utilities may charge for use, availability, and connection to the system. Funds

may be used for the federal Clean Water Act's NPDES permit application. They may also be applied to developing stormwater management, construction and maintenance of facilities, administration, and enforcement. Typical stormwater rates across the country range from \$20 to \$45 annually, per single-family residence. Fees for nonresidential development are usually based on the amount of impervious area on each property.

Transportation utility fees are still quite rare. Charges are based on usage estimates (trips by land use) and project budgets. Revenues can be used to fund maintenance, operating, and capital construction costs for road construction and maintenance.

Appropriate projects. Stormwater and road utilities are ideal where there are infrastructure deficiencies. A utility fund will receive revenues from all customers to address existing deficiencies, future capital needs and—very important—annual maintenance and operating expenses.

Advantages.

- Stormwater and transportation utility fees are usually broad based and can generate significant revenues to fund an activity that usually does not receive enough local dollars.
- Revenues can be used for maintenance and operations.
- Fees are usually billed on the same time schedule as utility fees
- Fees are not part of property tax rates and not part of the general fund budget.

Disadvantages.

- Stormwater and transportation utility fees are prohibited by some states.
- The local government usually will need a master plan to identify existing as well as future needs.
- These fees may be perceived as another form of tax.

Examples. Clark County, Washington, created a stormwater utility to support costs associated with the purchase, construction, and maintenance of stormwater management facilities. The nontraditional utility charges property owners based on their properties' contributions to stormwater runoff. Annual fees for single-family residences are \$21 per year (based on an assumption of 2,500 square feet of impervious surface). Multifamily residences and commercial/industrial developments are charged \$185 and \$240, respectively, per acre of impervious surface.

The city of Ashland, Oregon, has a transportation utility fee (TUF) that supports street maintenance, pedestrian facilities, handicapped access, and bicycle facilities. The TUF fund also pays for portions of local bus service. The fee, charged as part of the

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local monthly utility bill, is a flat fee for residential properties—\$3.27 for single-family dwellings and \$2.49 for multifamily dwellings. Fees for commercial development are based on the type of business and the number of trips the business is likely to generate. Rates range from \$0.15 per 100 square feet for a business with low trip-generation, such as a warehouse, to \$1.17 per 100 square feet for high-traffic businesses such as retail uses and offices.

Congestion Pricing and Tolls

The beneficiaries of certain public infrastructure pay tolls and congestion pricing, according to consumption levels, timing, or conveniences used. Congestion pricing and tolls can be used both to provide the financial means for expansion and to encourage the efficient use of existing resources, and revenues can be applied to both construction and maintenance costs.

Congestion pricing exacts more payment from users during periods of high demand, to encourage more balanced consumption. It is used to control situations where demand creates dramatic peaks and valleys of consumption, for example, in the use of roads, electric utilities, or mass transit.

Tolls affect consumer behavior by making it clear that public resources are not “free.” Tolls are most commonly applied to fund roads and bridges. They usually recoup only part of the original public or private capital investment, however. At least initially, tolls may not be a stable source of revenue. For example, the Dulles Greenway, a privately-owned toll road in Northern Virginia, had to restructure its financing, extending the term of the payback, to become viable.

Appropriate projects. Congestion pricing is best used where a resource such as a road can exact a higher fee in peak periods of use to maximize revenues and/or to discourage or shift use to off-peak periods.

Advantages.

- Congestion pricing and tolls increase revenues in most cases.
- They decrease overcrowding to some extent in most cases.
- They can be used as a dedicated revenue source to allow private or public-private construction and operation.
- Voter approval is usually not required.

Disadvantages.

- Projects that rely only on tolls for revenue may fail financially if demand is significantly lower than expected or slow in developing.
- If the project is privately operated, the fairness of the fees may be questioned.

- Consumers may feel that they are being taxed twice.

Examples. There are a number of electric utility examples. Transportation examples include transit systems, toll roads, and the San Francisco Bay Bridge. Southern California’s State Road 91 has in place a high-speed, electronic system to collect tolls from motorists. The tolls, ranging from \$0.25 at night to \$2.50 in peak hours, are collected in private toll lanes, through transponders mounted on each car’s windshield. Drivers make advance deposits into their accounts, and the transponder signals a debit to the account.

The electric industry is facing more and more state regulatory reforms, aimed at bringing more of the benefits of competition in the electric industry to citizens and businesses. Similar to traffic congestion, “transmission congestion” refers to conditions in which power lines are being used to full capacity and additional transmission between a generator and a user reduces the efficiency of other transmissions on the transmission grid. This is most likely to happen during peak demand periods. Typically, states attempting to encourage competition have included transmission congestion pricing, in a variety of formats, in their restructuring programs. In California’s “zonal transmission pricing” approach, for example, it is assumed that there are no transmission constraints within each service zone, and a single price is set within the zone.

Lease-Purchase Contracts and Certificates of Participation (COPs)

Lease-purchase contracts are installment sales agreements that allow a local jurisdiction to avoid issuing debt securities while purchasing equipment or facilities from a private source. A variation on this common financing mechanism is the issuance of securities called “certificates of participation” (COPs), secured by a stream of lease payments.

Most COPs contain non-appropriation language in the lease agreement (meaning that the government is not obligated to make payments for more than a year and must make annual appropriations to continue the lease). In most cases, the lease is terminated immediately if the local government does not appropriate funds to make the lease payment on the facility or equipment, but failure to appropriate does not constitute default by the local jurisdiction. The local government’s obligation never extends beyond one year. After a specified period of regular payments, the local government owns the goods or property.

Appropriate projects. State law determines whether a jurisdiction may use lease-purchase transactions and what type of purchase it may finance. In general, COPs are used for items that wear out or have inherent risks to ownership.

Advantages.

- When a jurisdiction has debt limitations, a lease-purchase contract permits additional investment in infrastructure.
- A local government usually does not need voter approval to enter a lease-purchase contract.
- COPs may be issued along with municipal bond insurance, to make the investments more attractive.
- Since COP transactions are typically not subject to competitive sales statutes, they can be marketed with more flexibility than general obligation (GO) bonds.

Disadvantages.

- COPs are more complicated than a normal lease (they usually have a trustee).
- COPs are usually less secure than GO bonds and have higher interest rates, since the law in many places prohibits the local government from using tax revenues to fund the payments. (Insurance may be available to cover these problems, however.)
- COPs are likely to be more costly in the long run since fees are based at least partially on a lease arrangement and also may require a debt service reserve fund.

Examples. In Milwaukee, Wisconsin, COPs helped to finance part of the construction of Miller Park Stadium. The COPs financed \$45 million of leased equipment (including the drive mechanism for the stadium's retractable roof and other high-tech items such as the scoreboard and sound system). The holder of the COPs is the stadium board, known as the Southeast Wisconsin Professional Baseball Park District. The district represents the state of Wisconsin, five counties, and the city of Milwaukee.

The city of Memphis uses COPs to provide itself with police cars and garbage trucks.

Special Assessment Districts

This section discusses one type of special district, the special assessment district. A special assessment district is created by a local government to provide one or several specific public services or improvements. Its operations and finances are usually controlled directly by local governments.¹ The special assessment district generates revenues that can be used to finance public bonds.

A special assessment district is created with voter approval and allows levies within a relatively small geographic area. Special assessments can be considered private financing, since homeowners and businesses located within the special assessment district—who benefit directly from the infrastructure improvements—fund the new, localized investment.

Special assessment districts are generally created to link costs and benefits resulting from new or upgraded infrastructure. There are hundreds of sewer, water, or road special assessment districts in the country. (School districts are not considered special assessment districts.)

Appropriate projects. Special assessment districts usually fund on-site, basic infrastructure projects such as local streets, curbs, sidewalks, streetlights, and sewer and/or water extensions, as well as stormwater management.

Advantages.

- Special assessment districts may be more politically acceptable and equitable than general tax increases, because they confine levies to the local users of benefits.
- Improvements within the district may raise property values.
- Special assessment districts can target funds to specific needs in different areas of a community.
- Special assessments have fewer restrictions imposed by federal or state law than exactions, impact fees, linkages, and user fees. Also the assessments are amortized, so that the annual payment is lower.
- Most states permit special assessment districts.
- Special assessment districts may fill a void, when the local government is unable or unwilling to provide needed services using the general fund.
- Special assessment districts help finance service provision in fast-growing areas.
- The revenue stream from special assessments may be more reliable than other financing methods, because it is based on an annual levy.

Disadvantages.

- Special assessments may be inappropriate to finance infrastructure with far-reaching benefits that are not confined to the assessment area.
- Special assessment districts are criticized by some for operating without significant public involvement and control.
- The creation of too many independent special assessment districts can result in the fragmentation of decision making and lack of local government coordination.

Examples. Portland, Oregon, uses local improvement districts (LIDs) as a financing tool to support the construction and upgrading of existing rights-of-way and to bring them up to city standards. Each district exists only through the end of the construction phase and imposes fees on the adjacent, benefiting properties, based on lot size. After the proposed LID is approved by a majority of voters and the city council, design and construction begin.

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Property owners may arrange (non-interest-free) financing through the city for up to 20 years.

Washington County, Maryland, formulated a road assessment district to expedite construction of roads for an industrial park. The assessment for each lot reflected its distance from the park's main roads: the further a lot was from a main road, the lower its assessment as a percentage of the whole. The formula included some general fund monies so that the assessments did not have to cover the total costs of the new roads.

Winter Springs, Florida, also created an assessment district with varying levels of assessment, to finance the construction of a sound barrier wall. The rate of assessment is reduced the further the property is from the wall.

Infrastructure needs for a new, 600-unit townhouse development in Woodview, an unincorporated area in Prince George's County, Maryland, included roads, stormwater management, and a recreation facility. To generate the necessary resources, the county established a special taxing district to finance special obligation bonds. In this plan, homebuyers may pay either an up-front fee at the time of purchase or an annual tax over a 20-year period.

Business Improvement Districts (BIDs)

A business improvement district (BID) is an independent special assessment district formed to improve the business climate within a designated commercial or industrial area. Independent special districts have characteristics of assessment districts but also have autonomy from local control and authority to issue bonds, enter into contracts for service, and impose user charges. Property owners in the district pay the assessment to support services and/or capital facilities intended to augment—not replace—services and facilities already provided by the local government.

Typically, BIDs are formed by an ordinance or resolution of the local government. Decisions affecting BID revenues are usually made by a board consisting of private property and business owners.

Most BID revenues are used to fund operating expenses in commercial business areas, for services such as sanitation and maintenance, police, or marketing and promotion activities. A BID may also pay for capital expenditures supporting the same goals, such as the purchase of a new sanitation vehicle.

Appropriate projects. BIDs are often practical for neglected commercial areas that are not receiving services and infrastructure they need to remain competitive.

Advantages.

- When a local jurisdiction has limited resources, a BID can address local problems in a focused, efficient manner.

- A BID can help create social and economic changes that benefit the real estate market and the community as a whole.
- BIDs are a relatively low-cost approach to the enhancement of a large area.
- BIDs increase the participation of businesses in coordinated community development.
- BIDs help downtown areas compete with malls by making possible the same type of coordinated property management and promotional services.

Disadvantages.

- Local law may make BIDs difficult and time-consuming to establish.
- Absentee owners and corporations may be hard to reach for support.

Examples. Queens, a borough of New York City, has seven BIDs and special assessment districts with budgets ranging from \$100,000 to \$250,000, established by the Queens business community to make the neighborhoods more safe and attractive, and to promote their own success.²

McMinnville, Oregon, has a BID in its central business district that raises \$54,500 each year to fund marketing, design assistance, economic restructuring, and administration of a Main Street program.

A BID in downtown Canandaigua, New York, is governed by property owners, business people, and civic leaders. The BID tracks retail trends for member businesses and the community. It provides information to new businesses and real estate agents looking for commercial space in the downtown. It also provides supplemental maintenance services: snow removal, sidewalk sweeping, trash pickup, and landscaping. Since the BID's inception in 1993, the vacancy rate in the downtown area has dropped from 15-20 percent to 5 percent, property turnover has dropped from about 30 percent to less than 10 percent, and property values have remained stable.

For more information on BIDs, see "Business Improvement Districts: Tool for Economic Development," MIS Report (ICMA, March 1997).

Special Taxing Districts

A special taxing district, sometimes also known as a municipal service district (MSD), permits the additional taxation of property owners within certain geographic boundaries, to fund additional special services provided within the service district. Revenues raised by an MSD can be used to pay for both capital improvements and operating expenses. Depending on state law, the municipal service district may be managed by the municipal government or by an autonomous governing body with the power to levy taxes and borrow funds.

Appropriate projects. Municipal service districts can be organized around a variety of different ser-

vices and facilities, such as ambulance and police services, parking, trash removal, sewage, stormwater drainage, beautification, and recreation.

Advantages.

- MSDs confine financing to beneficiaries of improvements.
- MSDs provide funds for both capital and operating expenses.

Disadvantages.

- Like special assessment districts, MSDs are inappropriate for improvements that benefit citizens outside the geographic area of the district.

Examples. Ponte Vedra Beach, Florida, an unincorporated area 25 miles southeast of Jacksonville, has an MSD to fund and manage a variety of projects including parking, road improvements, utilities, drainage projects, recreation, parks and open space, beautification, police protection, trash collection, and ambulance and rescue operations. The quasi-governmental agency is authorized by the state legislature and given the power to levy taxes and borrow funds. Most projects are fully funded with MSD assessments on district residents.

Approximately one-third of the counties in Florida use municipal service taxing units (MSTUs), a form of special tax district, to pay for local utilities and services. Revenues can also be used to support municipal and county-wide functions, such as the sheriff's office, the court system, and so on. For example, Palm Beach County has an MSTU to address fire-rescue needs in specific areas in the county.

Two historic districts in Greensboro, North Carolina, have MSDs that support minor improvements. The small districts levy an additional \$0.05 per \$100.00 tax on residential property tax assessments. The revenues from the two districts, which total approximately \$36,000 per year, fund beautification and streetscape improvements such as district entranceways, streetlights, signage, burying utility lines, and landscaping. The city collects and holds the funds, the neighborhood associations determine the scope of their use, and city staff assist in planning activities. For the first several years, MSD funds were matched with city appropriations, and an additional \$300,000 in general obligation financing assisted in jumpstarting the redevelopment project.

Utility Districts

Very prevalent, this form of special district is frequently used to provide water and wastewater services. The utility district is usually significantly larger than a special assessment district. Moreover, operating expenses as well as capital costs are reflected in its financial structure. Most communities have utilities, and if they are not financed as an enterprise fund, they are likely to be financed through

a utility district. Local residents/users in a utility district pay for the utility services through user fees and assessments. Generally, operating and capital expenses for any type of local utility can be financed through a utility district. For those jurisdictions that have electric or gas districts, the advent of deregulation may force changes to their exclusiveness.

Advantages.

- Revenue exactions through utility districts may be more politically acceptable and equitable than general tax increases, because they confine levies to the local users of benefits.
- Improvements within the district may raise property values.
- Utility districts can target funds to specific needs in different areas of a community.
- Utility districts have fewer legal restrictions on the calculation of infrastructure costs than impact fees.
- Most states permit utility districts.
- Utility districts may fill a void, when the local government is unable or unwilling to provide needed services using the general fund.
- Utility districts help finance services in fast-growing areas.
- Utility districts can be used to fund projects or services that cross jurisdictional boundaries.
- The revenue stream from utilities may be considered more certain than other financing methods, because it is based on an annual levy.

Disadvantages.

- For infrastructure with far-reaching benefits not confined to the assessment area, it may be inappropriate to use a utility district.
- Utility districts operate without significant public involvement and control.
- The creation of too many independent utility districts can result in the fragmentation of decision making and lack of local government coordination.

Examples. Jupiter, Florida, in the northern part of Palm Beach County, is served by the Loxahatchee River District (LRD) and a major wastewater treatment facility. The LRD is an independent special district that charges quarterly user fees to cover all operating expenses, which are about \$5.49 million annually. Residential quarterly fees range from \$32 to \$56, depending on the number of toilets in a residence. The LRD also collects connection fees from new development, in part to support renewal and replacement funds in the capital budget. Residential sewer connection fees range from \$1,360 to \$2,380, again depending on the number of toilets. Seven types of commercial fees and an industrial fee are also based on a per-toilet charge of \$1,360.

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Municipal utility districts (MUDs), created by a majority vote of local residents, are a popular mechanism for providing water and wastewater services and for maintaining drainage facilities within many Texas communities. Under state supervision, locally elected boards run the quasi-governmental MUDs, which may issue tax-exempt bonds serviced through tax levies on property within the district. The Wells Branch MUD, outside Austin, Texas, also provides trash collection, composting, and recycling services; operates a park system; and runs a conference center. MUD tax assessments fund approximately one-third of operating and capital expenses, while the remaining financial support comes from water and wastewater revenues. Some additional funds are collected through user fees. MUDs may be considered an alternative to incorporation: run by an elected body, the MUD provides essential services and leaves emergency services, policing activities, and human services to the county. However, a MUD can still be annexed by an incorporated community. In this case, the MUD continues to provide its services and the incorporated, annexing community provides other services.

Tax Increment Financing (TIF)

Tax increment financing, authorized in about 45 states, identifies increases in property tax revenue within a small geographic district that are due to new development or renovation. The incremental increases are earmarked for infrastructure improvements or services needed in that same district. Throughout the lifetime of the tax increment district, the tax contribution from the properties in the district to the municipal budget remains at the original, “baseline” levels; local governmental entities supported by the property tax, such as cities, schools, and counties, continue to receive property tax revenues reflecting the base valuation. Meanwhile, the increase in property tax revenue that is due to an increase in asset value over the “baseline” tax assessment is deposited in a tax increment fund. The TIF fund pays for necessary infrastructure improvements within the TIF district. Most of the fund usually goes to repay the TIF-backed bonds financing the public improvements in the district. When the TIF period ends, the local tax-supported entities start to receive the full tax benefits from the improved properties. The district is not an autonomous body and is dependent on the local jurisdiction.

A new concept that may become popular is the use of incremental sales tax revenues to finance facilities expected to have a positive effect on sales tax revenue, such as convention centers or arenas. The sales tax rate does not change, but increases in the amount of revenues collected in a defined area are dedicated to the facility being built.

Appropriate projects. A TIF district is useful if considerable capital facilities are needed within a geographic area, and these needs are not reflected in the city’s capital improvement plan. It is also useful in places where development is desired but funding for public facilities is not available. Tax increment financing is best used for commercial development and redevelopment because these forms of development generate a positive fiscal impact and new jobs, which are necessary to the success of the TIF. Depending on state regulations, TIF funds can be used for a wide range of purposes, such as property acquisition, site preparation and improvements, rehabilitation and construction costs, economic development, public streets and utilities, professional and administrative fees, or other soft costs.

Advantages.

- Tax increment financing is usually accepted by the community and developers alike.
- Unlike some other financing tools, such as impact fees, tax increment financing is not limited to new development only.
- Tax increment financing can be used to develop mixed-use office/retail/residential projects.
- Tax increment financing may help to combat problems of deteriorating neighborhoods and encourages redevelopment of existing, high-density areas.
- Tax increment financing can encourage new, private investment in an area that may not otherwise have been developed. TIF funding of improvements may also jumpstart development in surrounding areas.
- When the incremental increase in tax revenues due to new growth is diverted to a TIF fund to pay off debt, the jurisdiction’s financing is more effective than if the same costs are paid with general property tax revenues because property taxes must also be distributed to counties, schools, and other taxing districts.

Disadvantages.

- The new development is likely to create additional needs for public services, but the jurisdiction will not receive the increased property taxes from the TIF district until the TIF-backed bonds are retired. (In some states, like Minnesota, even at retirement of the bonds the jurisdiction’s revenues may not increase because the formula for calculating tax rates reflects tax capacity. The TIF revenues are included in the total levy, so total tax capacity increases. Therefore, the tax rate is lowered and the TIF revenues do not result in more general fund dollars.)
- Since the municipality and other taxing authorities will not receive the tax benefits of the property improvements for an extended period of time, public concern over funding may hamper the approval of a TIF district.

- The other taxing districts lose the benefits of the increased property tax assessments for an extended period of time, unless there is a reimbursement agreement. (A reimbursement formula was used in Dublin, Ohio, to reimburse the school district.)
- TIF funds can generally be used only for capital infrastructure.
- Depending on the tax base, the increment gained by the jurisdiction may be minimal, or may grow very slowly.
- Existing businesses may be forced to relocate permanently because of higher rent or incompatibility with the new development.
- The TIF-backed bond is likely to have a higher interest rate than a GO or revenue bond.

Examples. A new mall in Anne Arundel County, Maryland, is expected to increase tax revenues and create jobs. The county has issued 20-year bonds to pay for the major infrastructure that will be required by the project, including a new highway interchange. The planned tax increment financing for the district will be more than sufficient to pay debt service on the bonds.

Bloomington, Indiana, uses TIF districts to face dual economic pressures: First, extensive karst deposits (a weak form of limestone) make much of the city's land inappropriate for large commercial/industrial parks. Second, strong growth rates in the last 10 years have placed increasing demands on the existing infrastructure. To answer this challenge, the city annexed approximately 500 acres of nearby, undeveloped land and established four TIF districts on the parcels, in expectation of continued growth. The city also established two other TIF districts in blighted areas within its borders. By issuing TIF-backed revenue bonds, the city was able to upgrade roads and other transportation-related infrastructure to promote focused, high-value development in the newly zoned areas. Some TIF districts are growing rapidly, and the others are expected to follow.

PARTNERING

Privatization or Public-Private Partnership

Financing infrastructure or service delivery by combining public and private financing is based on identification of common goals and mutual interests. The local government may use any of the financing tools described earlier in this report, or finance the portion of the project eligible for tax-exempt debt, while the private partner guarantees a taxable municipal bond issue or contributes funds upfront.

Private financing of infrastructure has higher direct costs than public financing, because governments have access to lower interest rates, particularly if the debt is exempt from federal (and state) income

tax. However, a turnkey project in which the developer builds the infrastructure (e.g., roads) can produce time and money savings that more than compensate for the higher interest costs.

Another consideration is the debt capacity of the jurisdiction. Giving the private sector responsibility for purchasing capital equipment that the jurisdiction would otherwise have to finance relieves some of the burden on its debt capacity.

Forms of privatization used for capital financing include:

- *Contracting out.* The local government contracts with a private firm for specific service delivery. The private firm assumes the costs of providing the necessary facilities and equipment, such as vehicles or machinery.
- *Franchise agreements.* The local government grants a private firm the right to provide a particular service within a geographic area. The agreement may be exclusive or nonexclusive. Again, the private firm assumes the cost of providing equipment.
- *Specific projects.* The local government subsidizes the capital costs and possibly the operating expenses of a specific project, such as a conference and hotel center. The private partner builds, operates, and pays for some of the infrastructure.

Appropriate projects. Services should be provided more efficiently by the private sector and should address equity concerns, without compromising community security. Garbage collection, recycling, water and wastewater systems, and toll roads are some typical examples. Also, projects that combine private construction or services with public facilities may be addressed through partnership.

Advantages.

- Privatization may lower operating and construction costs and increase productivity.
- Privatization can help a locality address demand for new or expanded services while avoiding budget cutbacks in other areas and staying within bonded debt capacity limits.
- Partnerships often generate bipartisan support.
- Coordinated financing and construction of a joint venture may reduce costs if the private sector is responsible for construction. Savings will be due primarily to reductions in the time needed for government review and approvals at different levels and to reductions in labor costs.
- The private partner may enjoy a reduced interest rate, if the local government assumes all or part of the debt service on the taxable debt.

Disadvantages.

- Privatization may not be appropriate for necessary services that would be put at risk if the private provider stopped providing them.

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- If the locality becomes dissatisfied with the private contractor's service, or the private contractor discontinues the service, the local government may have difficulty resuming its own provision of the service.
- It is more expensive to use private (taxable) financing for a project, rather than public (tax-exempt) financing.
- Federal tax law regarding project qualifications for tax-exempt financing is complex.
- There may be political pressure not to dismiss government employees currently performing a service to be privatized.

Examples. Franklin, Ohio, privatized its wastewater treatment plant in 1995.³ Local leaders chose privatization because of the high cost of compliance with mandates, requirements, and regulations. The purchase price was used to repay debt for the facility's construction, and the balance was divided among local jurisdictions and the newly-created wastewater treatment corporation. An advisory board represented the local government in managing the transfer to the private entity and ensuring quality work from the private entity.

Knox County, Tennessee, contracts with Rural Metro, headquartered in Phoenix, Arizona, for fire services. All the capital costs are reflected in the annual contract amount. (Rural Metro has similar arrangements with a number of Arizona communities.)

In an example of a public-public partnership, Deerfield Beach, Florida, contracts with the Broward County Sheriff's Office for its police services. The contract saves the city direct capital outlays for police equipment, including expenditures for dispatch and communication infrastructure.

Jurisdictional Revenue Sharing

Jurisdictional revenue sharing involves restructuring a tax or fee system to permit non-traditional and flexible allocations of funds between or among neighboring jurisdictions. It can be applied to meet a variety of needs. Communities form financial and service partnerships to pursue fiscal equity, efficiency in service delivery, and regional cooperation. Revenue sharing agreements permit localities to cooperate instead of competing.

It must be recognized, however, that it is difficult to alleviate all economic disparities, and in some cases, the competition for a strong tax base has remained fierce, despite reallocation of revenues.

Appropriate projects. Jurisdictional revenue sharing may be appropriate in situations where a concentration of major institutions serves an entire region, or in locations where intense jurisdictional competition for sales or property tax revenues may have a debilitating effect on a local economy. Revenue sharing may also lessen competition over annexation of ratable lands.

Advantages.

- Jurisdictional revenue sharing has an equalizing effect, allowing an economically weaker jurisdiction to avoid offering expensive incentives to prevent employment from relocating, for example.
- Each jurisdiction can concentrate on the service or function it performs best.
- Each jurisdiction can save money by not investing in and duplicating the activities provided by the neighboring jurisdiction.
- Jurisdictional revenue sharing can promote economic investment and revitalization of a decaying urban core.

Disadvantages.

- There may be public pressure to keep tax revenues in the jurisdiction where they are collected.

Examples. Funded with half the revenue from a countywide sales tax, the Regional Asset District in Allegheny County, Pennsylvania, supports regional parks, libraries, a zoo, Three Rivers Stadium, and various cultural facilities. The other half of the revenue is divided among the county and cities, with at least two-thirds applied to reduce local taxes. The district, which includes Pittsburgh and 130 suburban cities, was created in 1993 by the county commissioners and authorized by the Pennsylvania general assembly.

The Economic Development/Government Equity (ED/GE) program in Montgomery County, Ohio, pools tax revenues to reallocate them for economic development. ED/GE collects its funds from a 1/2 percent county sales tax increase and allocates \$5 million per year to economic development activities. Designed as gap funding, the program helps to fund infrastructure in industrial park sites, equipment purchases, roadways, streets, and sewers, plus other activities that help create jobs, such as business expansion and relocation of businesses into the county. In its first seven years, ED/GE financed \$33 million in projects and leveraged \$1 billion in private/public funds.

Westminster and Thornton, Colorado, two municipalities in the Denver area, cooperate to share sales taxes from a discrete area at their boundary. The sales tax is a significant source of revenue and it is based on point of sale. In the interest of better planning, and to avoid offering competing incentives to attract retailers, the two cities decided to each annex one side of a four-mile portion of Interstate 25. According to their agreement, one third of sales and admissions tax revenues are retained by the jurisdiction that collects the tax, and the remaining two thirds are shared, based upon the percentage that each locality's tax rate constitutes of the total of the two tax rates combined.

DEVELOPER CONTRIBUTIONS

Exactions

Exactions are developer-funded, in-kind contributions of land, facilities, or services that are demanded as a condition of development approval. Negotiated agreements between the developer and the local jurisdiction traditionally include off-site infrastructure, such as roads, water and sewer lines, and site contributions (e.g., for schools or parks). Linkage programs, a related revenue mechanism, offer an additional method of funding off-site development. For instance, a housing linkage program would require the development of new off-site housing, or monetary contributions for such development. The level of off-site development exactions is usually reached through negotiations, while standardized guidelines often provide information on allocating costs for on-site infrastructure. It is the regulatory authority of local governments that permits them to require exactions. Exactions are usually linked to subdivision approvals or annexation agreements.

Appropriate projects. Any subdivision or project can be considered appropriate, since relevant off-site improvements frequently include streets, local water and sewer lines, and drainage improvements.

Advantages.

- The costs of infrastructure needed by new development are paid for by the developer.
- Jurisdictions avoid spending general tax revenues on infrastructure related to new development.
- Development project costs are forced to reflect the different costs of different locations or types of infrastructure.

Disadvantages.

- Exactions, and especially their timing, can be unwieldy when applied to large projects and can be underestimated if smaller projects are considered in isolation (it is easy to underestimate the cumulative impact of several small projects).
- Negotiations can entail high administrative costs, uncertainty, and legal expenses for both parties.
- Exactions usually do not adequately address “downstream” impacts, such as the impact on roads beyond the property, or on operations and maintenance of service facilities.
- Exactions may be inequitable, for instance, if developers with frontage on a collector street are required to improve the street, while the development immediately beyond makes no contribution.
- Piecemeal improvements negotiated with developers may create gaps or bottlenecks in the infrastructure.

Examples. Dedication of roads and utilities is the most common type of exaction, and examples abound. They are usually included in a subdivision agreement or formal development agreement and are often tied to a development rezoning plan. Small municipalities faced with strong growth pressures, or newly annexed areas on the edge of development, are often unable to support the necessary infrastructure.

Impact Fees

Impact fees, also known as development fees, are one-time cash payments required of developers to pay for the new development’s fair share of capital facilities. Depending on state legislation, impact fees can be used to pay for water and sewer, parks, libraries, schools, fire, police, roads, transit, and general government facilities and equipment.

The fees imposed must meet two important tests: the “substantial benefit” and the “rational nexus” tests. The tests require a reasonable relationship between the amount of the fee and the actual cost of capital facilities needed to accommodate new development. Because impact fees are not a tax but are based on the local government’s police power (or the state’s authority), the fee payer must receive a substantial benefit. Thus impact fees require consideration of geographic service areas and the time period when the money will be used. Enabling legislation and/or case law require fees to be proportionate, or non-discriminating, and to account for possible credits. In some cases, waivers or reductions may be allowed, although the jurisdiction must fund the difference. This is one reason why a cash flow analysis should be part of an impact fee study.

There are three methodologies that can be used to calculate impact fees: 1) plan-based, 2) incremental expansion, and 3) buy-in. The *plan-based* approach is usually based on a master plan or facility study that indicates what facilities will be needed over a certain time frame to service projected development. For example, the fire and rescue department may have determined that they will need two additional fire stations to maintain their current level of service for development expected over the next five years.

Under the *incremental expansion* approach, capital items are added incrementally to meet growth needs based on current level-of-service standards. For example, if the local government determines that new development will require the addition of police personnel, the number of police cars required also goes up.

The *buy-in* methodology is used when the local government has already oversized capital facilities from which new growth will benefit. An example might be a wastewater treatment plant constructed with bond financing that has excess capacity intended to accommodate future growth. This approach can be used with either of the first two approaches.

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Appropriate projects. Impact fees are generally appropriate when growth is 3 to 4 percent per year. (However, Tischler & Associates, Inc. has calculated impact fees for communities with lower growth rates but a relatively large base of existing development.)

Advantages.

- Impact fees can help meet local capital facility needs due to new growth without raising taxes.
- Impact fees are politically attractive, since they pass on costs to future (absentee) voters.
- Impact fees shift the fiscal burden to new development and subject growth to pricing realities.
- Impact fees coordinate new growth with the services demanded.
- Impact fees add certainty to the development process by encouraging capital improvement plans, providing funding for infrastructure, and providing developers and builders with a specific, known fee schedule.

Disadvantages.

- Impact fees go only to pay for capital facilities benefiting the fee payer and cannot be used for operating expenses (operating expenses usually account for 80 to 90 percent of a jurisdiction's budget).
- The collected fees must be spent within a reasonable time period, often about six years.
- A jurisdiction may not use impact fees to support a higher level of service, unless it has a plan in place to address deficiencies created by the existing development.
- Some new homebuyers may already be residents within the jurisdiction; they have already been paying for capital facility needs through the existing tax base.
- New homebuyers are forced to "buy into" the capital facilities with a one-time fee, as opposed to the traditional application of taxation to finance capital facilities.

Exhibit 3 Impact Fee Summary—Carroll County, Maryland

This summary of impact fees collected over an 11-year period in Carroll County, Maryland, illustrates the importance this form of financing can assume in a local government budget. Carroll County, with 150,000 residents, has a budget of approximately \$175 million. The average market value of a new single-family house is \$200,000. Population has grown at an annual rate of approximately 2.2 percent since 1990.

Net Impact Fee Collections for Schools and Parks by Fiscal Year:

	Total	Schools	Parks
FY89	368,671.78	341,338.55	27,333.23
FY90	2,535,120.76	2,336,089.54	199,031.22
FY91	1,976,067.16	1,827,455.52	148,611.64
FY92	2,357,399.26	2,182,353.63	175,045.63
FY93	2,818,505.51	2,609,335.48	209,170.03
FY94	4,137,735.14	3,831,202.54	306,532.60
FY95	4,266,303.82	3,906,563.07	359,740.75
FY96	5,542,020.10	4,941,372.08	600,648.02
FY97	4,202,002.12	3,753,145.09	448,856.03
FY98	4,257,541.96	3,794,175.70	463,366.26
FY99	2,414,565.98	2,133,201.54	281,364.44
Net Collections FY89-FY99	34,892,932.70	31,655,232.85	3,237,699.85
Appropriations Through FY99	34,321,806.80	32,254,338.40	2,067,468.40
Impact Fee Study	32,552.74	30,141.43	2,411.31
Unappropriated Balance	538,573.16	(629,246.98)	1,167,820.14

- Since impact fees are collected from new growth only, they do not ensure a steady source of revenue.
- Since the formulas for calculating impact fees are usually quite rigorous in reflecting proportional costs, rational nexus criteria, and credits (to avoid double payment), jurisdictions usually need outside expert help to institute impact fees.

Examples. Some states have specific enabling legislation for impact fees. For example, Utah allows fees for water, wastewater, stormwater, municipal power, roads, parks, and public safety facilities (but not jails or prisons). States like Florida allow impact fees as part of the police power. Legal requirements from case law are also an important consideration.

The period from proposal to adoption of impact fees is usually six months to a year. The length of time required is a function of the local and regional political climate as well as the number and size of the fees proposed. In the vast majority of cases, developers and homebuilders will reluctantly accept the implementation of impact fees. The stronger the market or the lower the fees, the more ready the acceptance. Impact fees are most commonly used to pay for water, sewer, roads, parks, schools (where allowed), fire, police, libraries, public works, and municipal facilities. Even if the jurisdiction imposes impact fees at the maximum amount that can be justified, revenues from the fees will usually pay for only 60 to 90 percent of the cost of the supported facility—future related tax payments requiring credits or disallowed existing deficiencies will account for the difference.

STATE SOURCES

Bond Banks

A bond bank is typically an independent, state-sponsored entity that provides low-cost financing to local governments through debt issuance with state backing. A bond bank may be a private or non-profit body. It may have a broad focus or it may issue debt for a single purpose only. Local jurisdictions pool the individual costs of issuing bonds and combine their financing needs to create a larger, more attractive issue that can be marketed nationally. The bond bank purchases the bonds from the local jurisdictions, which then repay the funds with interest. State credit assurances and dispersed risk can assist in reducing the interest rate the local governments pay on the bonds.

Bond banks can generally fund a variety of capital projects. Their greatest benefits are to small communities, especially those that may not be able to participate in the national bond market because of inexperience, the small size of the bond issues they are floating, or a weak credit rating. Some states use federal grants, for instance, those pertaining to water and transportation, to subsidize the interest rates.

Revolving Loan Funds

A state revolving loan fund is a permanent source of money, or one that is fed by a state revenue stream, that is lent out to smaller jurisdictions. As original borrowers repay their loans, the revolving fund re-lends the money to other jurisdictions. In this way, the original investment benefits many communities and the endowment increases, eventually forming a self-sufficient loan fund. Revolving loan funds typically offer below-market-rate interest, low monthly payments, and extended repayment periods of 20 years or more. In some states, these loans are available to communities with poor credit ratings, or that are too small to enter the bond market. However, revolving loan funds are generally for very specific purposes, and local infrastructure goals must meet state or federal program requirements.

Growth Management Rewards

Some states reward localities that follow “smart growth” guidelines by funding local or regional infrastructure in certain areas. Rewards may be made to jurisdictions that concentrate development in locally designated “growth” areas, form interlocal planning agreements, or otherwise act to reduce infrastructure demand.⁴ In addition, the state may give local jurisdictions revenue-raising authority if they coordinate their activities with regional and state-wide growth management activities.

Several states currently have such programs, including Maryland, Oregon, and Colorado. For example, under Maryland’s Smart Growth policy, the state will only fund new utility infrastructure in areas that local jurisdictions have defined as “Smart Growth” areas. The objective is to slow sprawling growth. Since this mechanism is in its initial stages, it will take some time to ascertain its success.

Some localities address sprawl on a local level, through ordinances requiring that adequate infrastructure and public facilities be in place before or at the time development is approved (the state of Florida refers to this type of ordinance as a “concurrency” ordinance). Also related is an adequate public facilities ordinance, which may offer a little more leeway in the timing of new facilities.

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- 2 Michael Butler, “Business Improvement Districts in Queens County, New York City,” *News & Views, Economic Development Division of the American Planning Association* (July 1998): 1-15.
- 3 Samuel L. Coxson, “Privatizing Wastewater Treatment in Franklin, Ohio,” *Government Finance Review* (February 1996): 36-37.
- 4 John R. Nolon, “Accommodating Home Rule in State Land-Use Reform,” *Modernizing State Planning Statutes, The Growing Smart Working Papers*, v. 1. (Washington, DC: American Planning Association, 1996): 43-46.

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