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PROJECT DEVELOPMENT FINANCING: COMBATING BLIGHT AND PROMOTING ECONOMIC DEVELOPMENT THROUGH TAX INCREMENT FUNDING

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Introduction

Local governments in North Carolina have another tool to use in their efforts to improve blighted, deteriorated, or economically depressed areas and promote economic and community development. The tool, a financing instrument termed *project development financing* in the North Carolina Constitution, is more commonly known as *tax increment financing*. This bulletin explains the purposes of project development—or tax increment—financing, discusses various policy implications underlying its use, and describes how it became available to North Carolina local governments. It then outlines the statutorily prescribed steps for using project development financing and provides an example of how it might work in practice.

Purpose of Project Development Financing

Project development financing is a method of increasing the overall property value in a district that is currently blighted, depressed, or underdeveloped. Using the development financing designation, a county or city borrows money to fund public improvements in the area, with the goal of attracting private investment. The debt incurred by funding the improvements is repaid (and secured) by tax increment revenue—the additional property taxes resulting from the district's new development.[1]

In enacting North Carolina's Project Development Financing Act in 2003, the General Assembly cited the need for local governments to be "actively engaged in economic development efforts to attract and stimulate private sector job creation and capital investors." The act notes that local governments in other states have succeeded in creating jobs and investment through incentive packages that included infrastructure improvements financed through project development bonds.[2]

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Local officials pursuing project development financing most commonly cite the need to remedy blight and spur economic and community development.[3] Investment in a blighted area generally is justified on the assumption that an external intervention is needed to reverse a downward spiral of deterioration, attract private firms, and create jobs.[4] While local officials' specific policy reasons and the individual philosophies underpinning project development financing may vary, the overall goal—an increase in the assessed value of property in the development financing district—remains the same.

Studies on Tax Increment Financing

Much of the literature on tax increment financing either advocates for it as a productive means for addressing blighted areas or argues that it simply represents an incentive program for developers.[5] Fortunately, several empirical studies provide a more balanced perspective on tax increment financing. These studies are especially useful for framing the following policy decision: Is tax increment financing (project development financing) appropriate for my jurisdiction?

One study explored the conditions and factors that motivated municipalities to choose tax increment financing as a debt financing tool.[6] It found that tax increment financing was more likely to be used in municipalities with high tax burdens and large nonresidential tax bases. It also found stagnant growth in property values a determining motive for using this form of financing. Because of this problematic history of growth, some local governments have had to pledge additional revenue sources to guarantee repayment of tax increment bonds. Such pledges are allowed under North Carolina's project development financing statutes.[7]

North Carolina's project development financing statutes also address the issue of sluggish property values by permitting local governments and individual owners of real property in the development financing district to enter into agreements establishing minimum assessed values for properties.[8] The county tax assessor will assess property at the agreed-upon value if it is higher than the market value of the property. If, however, the property has a market value higher than the minimum agreed-upon value, the higher value will be used for assessment purposes.[9] The existence of these agreements helps ensure that there will be a minimum tax increment for the development financing district.

In designing a development financing district, local government officials should attempt to minimize the number of properties in the district that are exempted or excluded from property taxation. Research has shown that the presence of tax-exempt properties in tax increment financing districts suppresses the overall property valuation, which could ultimately affect the local government's ability to repay tax increment bonds.[10]

A common concern regarding tax increment financing is the possibility that pledging all tax revenues from the district's incremental value will hinder a taxing unit's ability to pay for services needed during the bond repayment period. After all, the base value of property in a development financing district in North Carolina is determined by the taxable property located in the district as of the January 1 preceding its creation for a period of thirty years or the time it takes to repay the bonds.[11] While this base value will usually increase in revaluation years, it will not, during the lifetime of the district, include the value of improvements to the property made after the district's creation. During the repayment period, all tax revenues resulting from the incremental property value in the district must first fund repayment of bonds and satisfy other project development financing requirements before being remitted to a county's or city's general fund.[12]

One study examining this issue, using baseline projections, found no evidence that tax increment financing would result in future financial constraints on service delivery.[13] Given that a North Carolina county or city may place only a limited portion of its property—no more than 5 percent of the total land area—into development financing districts, it seems most likely that these findings would hold true for project development financing in North Carolina. That is, the inability to fund services from taxation of the incremental value on 5 percent or less of a taxing unit's property is unlikely to significantly hinder its ability to provide unit-wide services. However, while such a district probably will not place a drain on a local government's public service funds, it is unlikely, according to another study, to create an overall, long-term financial boom for the county or city.[14] Again, given the limited percentage of property that may be placed in development financing districts and the numerous policy decisions that affect a local government's financial condition, it is reasonable to expect a similar outcome in North Carolina.

So what can we conclude about the viability of tax increment financing from these empirical studies? One conclusion is that this form of debt financing provides local governments in North Carolina with a useful tool for addressing blight and promoting

economic development. Another is that tax increment financing does not represent a panacea for improving the overall financial condition of a community. In a study showing that tax increment financing had a positive impact on local employment, the author still noted that governments need to consider all benefit and cost factors before adopting this kind of debt financing.[15]

Constitutional Amendment in North Carolina

The North Carolina Constitution generally bars local governments from issuing debt instruments secured by a pledge of their taxing power unless they are approved by referendum.[16] Because project development financing bonds are repaid from taxes levied on the incremental value of property in development financing districts, the pledge of these taxes without voter approval runs afoul of that constitutional provision. Therefore, a constitutional amendment as well as authorizing legislation from the General Assembly were necessary to create project development financing in North Carolina; without the amendment no local government was willing to issue debt secured by a pledge that, upon challenge, would most likely be ruled unconstitutional.

State voters approved such an amendment on November 11, 2004. Section 14 of Article V of the North Carolina Constitution now expressly permits local governments to issue debt instruments secured by proceeds from a tax increment and by revenues available to the taxing unit from sources other than its taxing power. Section 14 also expressly authorizes the issuance of this debt without voter approval so long as only tax increment revenues and revenues from sources other than the issuing unit's taxing power are pledged for repayment.

Section 14 remedied another constitutional problem with project development financing that related to the constitutional rules governing the taxation of property. Article V, Section 2 of the North Carolina Constitution permits the General Assembly to classify property for taxation if the classifications apply on a statewide basis and each class of property is taxed according to a uniform rule. The uniform rule of appraisal and assessment applicable to most property, by virtue of state statute, requires that property be appraised and assessed for taxation at its true or market value.[17] The constitutional amendment passed in 2004, and embodied in Section 14 of Article V, permits the General Assembly to enact laws allowing a taxing unit to make agreements with property owners to assess property at a minimum value and provides that the agreed-upon minimum value is binding on the current and any future owners during the lifetime of the project development district. Without the constitutional amendment, the nonuniform assessment of property at a minimum value agreed upon by the property owner and the local government—as provided for in the Project Development Financing Act—would have been unconstitutional.

The Project Development Financing Act

The General Assembly enacted the Project Development Financing Act in 2003, although the act, codified as Article 6 of Chapter 159 of the General Statutes, did not become effective until voters approved the constitutional amendment adding Section 14 to Article V of the state constitution in 2004. The act permits counties and municipal corporations (hereinafter referred to as *cities*) to issue project development financing bonds and to use the proceeds for many, but not all, the purposes for which a taxing unit may issue general obligation bonds.[18] Table 1 sets forth the purposes for which project development financing proceeds may be used.[19]

It should be noted that the act defines *capital costs* to include interest on project development financing bonds, and on notes issued in anticipation of the bonds, for a period not exceeding seven years after the estimated date for completing construction projects.[20] The provision establishing this deadline for capitalizing interest on project development bonds recognizes the reality that time is required to create a sufficient incremental assessed value for amortizing principal and interest. Capital costs for which bond proceeds may be expended also may include the establishment of debt service reserve funds, which often are required by bond covenants.[21] Bond proceeds may be used outside the development financing district if their use directly benefits private development inside the district.[22] They might be used, for example, to provide water and sewer utilities to a private development in the district.

Unlike those from general obligation bonds, proceeds from project development financing may *not* be used for the following purposes:

- beach improvements (other than in a municipal service district)
- fire stations
- police stations and jails

Table 1. Permissible Uses of Project Development Bonds

Purpose	City	County	Statutory Authority: G.S. 159-103(a)
Capital costs of providing airport facilities	X	X	G.S. 159-48(b)(1)
Capital costs of providing hospital facilities, and facilities for the provision of public health services, and facilities for care of the mentally retarded	X	X	G.S. 159-48(b)(3)
Capital costs of providing auditoriums, coliseums, arenas, stadiums, civic centers, convention centers, and facilities for exhibitions, athletic and cultural events, shows, and public gatherings	X	X	G.S. 159-48(b)(7)
Capital costs of art galleries, museums, art centers, and historic properties	X	X	G.S. 159-48(b)(11)
Capital costs of on- and off-street parking and parking facilities, including meters, buildings, garages, driveways, and approaches open to public use	X	X	G.S. 159-48(b)(12)
Capital costs of redevelopment through acquisition and improvement of land for assisting local redevelopment commissions	X	X	G.S. 159-48(b)(16)
Capital costs of sanitary sewer systems	X	X	G.S. 159-48(b)(17)
Capital costs of storm sewers and flood control facilities	X	X	G.S. 159-48(b)(19)
Capital costs of water systems, including facilities for supply, storage, treatment, and distribution of water	X	X	G.S. 159-48(b)(21)
Capital costs of public transportation facilities, including equipment, buses, railways, ferries, and garages	X	X	G.S. 159-48(b)(23)
Capital costs of industrial parks, including land and shell buildings, in order to provide employment opportunities for citizens of county or city	X	X	G.S. 159-48(b)(24)
Capital costs of property to preserve a railroad corridor	X	X	G.S. 159-48(b)(25)
Capital costs of improvements to subdivision and residential streets		X	G.S. 159-48(c)(4a)
To finance housing projects for persons of low or moderate income		X	G.S. 159-48(c)(6)
Capital costs of electric systems	X		G.S. 159-48(d)(3)
Capital costs of gas systems	X		G.S. 159-48(d)(4)
Capital costs of streets and sidewalks	X		G.S. 159-48(d)(5)
Capital costs of improving existing systems or facilities for transmission or distribution of telephone services	X		G.S. 159-48(d)(6)
Capital costs of housing projects for low- or moderate-income persons	X		G.S. 159-48(d)(7)

- libraries
- parks and golf courses
- general public buildings, including city halls, courthouses, and office buildings
- public vehicles
- landfills and transfer stations
- community colleges and schools[23]

Establishing a Development Financing District

At the outset of a project development financing project, a county or city must establish a development financing district.[24] A county district must consist of property that is (1) blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed from the standpoint of sound community development and growth; (2) appropriate for rehabilitation or conservation activities; or (3) appropriate for economic development.[25]

A city district must consist of property that meets at least one of the conditions set forth for a county district in G.S. 158-7.3(c) or that meets the criteria of an urban redevelopment area as defined by G.S. 160A-503. A city's planning commission may designate the following types of property as a redevelopment area:

1. property that is blighted because of dilapidated, deteriorated, aged, or obsolete buildings; inadequate ventilation, light, air, sanitation, or open spaces; high density of population or overcrowding; or unsanitary or unsafe conditions;
2. a nonresidential redevelopment area with dilapidated, deteriorated, aged, or obsolete buildings; inadequate ventilation, light, air, sanitation, or open spaces; defective or inadequate street layout or faulty lot layout; tax or special assessment delinquency exceeding the value of the property; or unsanitary or unsafe conditions,
3. a rehabilitation, conservation, and reconditioning area in present danger of becoming a blighted or nonresidential redevelopment area; or
4. any combination of the above types of areas.

Additional limitations apply to development financing districts established pursuant to G.S. 158-7.3 and located outside a city's central business district. The development financing plan for such a district may provide for no more than 20 percent of the plan's estimated square footage of private development floor space to be used for retail sales, hotels, banking and financial services offered directly to consumers, and other commercial uses other than office space.[26] The 20-percent limitation does not apply to development financing districts located in development tier one areas that are created primarily for tourism-related economic development.[27] An example of tourism-related economic development is a development featuring an auto racing complex or a park and recreation facility.

The total land area within a county or city development financing district may not exceed 5 percent of the total land area in the taxing unit.[28] Though not explicitly defined by the act, the term *unit* apparently refers to the county or city establishing the district and pledging its incremental tax revenues in support thereof.[29] Counties are specifically prohibited from including in a development financing district land located within a city at the time the district is created, although a county or city may jointly agree to create such a district.[30] In the absence of such an agreement, any land included in a development financing district established by a city that issues debt instruments to be repaid from the incremental valuation does not count against the 5 percent of unincorporated land in that county that may be included in a development financing district.

Conversely, land in a county district that subsequently is annexed by a city does not count against the city's 5-percent limit unless the county and city have entered into an *increment agreement*; in such an agreement the city agrees that city taxes collected on part or all of the incremental valuation in the district will be paid into the reserve increment fund for the district.[31] In the absence of such an agreement, the annexed land in the district continues to count against the county's 5-percent limit and the proceeds of taxes levied by the city against the annexed land are retained by the city. The city's retention of these funds does not adversely affect the project development financing bonds issued by the county because the city's tax levy on the annexed property was not pledged as part of the original bond issue.

Counties and cities, as previously noted, may act jointly to create a development financing district.[32] Because the term *unit* is not defined, there may be some question about how the 5-percent limit applies to a joint district. The most consistent interpretation of the act's provisions leads to the conclusion that when counties and cities jointly act to develop a development financing district, with each unit pledging its incremental tax revenue in support thereof, then the area included within the district counts against the 5-percent limitation for both the county and the city.

Table 2. Basic Requirements of a Development Financing Plan

1) A description of the boundaries of the development financing district
2) A description of the proposed development, both public and private
3) The costs of the proposed public activities
4) The sources and amounts of funds to pay for the proposed public activities (depending on the scope of the project, may include funds in addition to the debt proceeds from project development bonds)
5) The base valuation of the development financing district
6) The projected increase in the assessed valuation of property in the district
7) The estimated duration of the development financing district (the earlier of thirty years from the effective date of the district or when the bonds are repaid)
8) A description of how the proposed public and private development of the district will benefit district residents and business owners in terms of jobs, affordable housing, or services
9) A description of appropriate ameliorative activities if the proposed projects negatively impact district residents or business owners in terms of jobs, affordable housing, services, or displacement
10) A statement that that the initial users of any new manufacturing facilities included in the plan will be required to pay an average wage that is above the average manufacturing wage paid in the county or is not less than 10 percent above the average weekly manufacturing wage statewide, unless an exemption to such requirements is approved by the secretary of commerce as required by G.S. 158-7.3(d), (e) and 160A-515.1(c), (d)

Adopting a Development Financing Plan

The most laborious component of a project development financing venture is establishment of a development financing plan. Table 2 contains the basic requirements that counties and cities must satisfy in establishing a development financing plan.[33] They also must submit any plan that involves the construction and operation of a new manufacturing facility to the secretary of the Department Environment and Natural Resources (DENR). The secretary's review will determine whether the facility will have a materially adverse effect on the environment and whether the company that will operate the facility has previously complied with federal and state environmental laws and regulations.[34]

Notice and hearing requirements. Before a city adopts a plan for a development financing district, it must send notice of the plan by first-class mail to the county or counties in which the district is located.[35] Unless a board of county commissioners disapproves the plan by resolution within the twenty-eight days following the date the notice is mailed, the city's governing body may proceed to adopt the plan,[36] but must hold a public hearing before doing so.[37] No more than thirty days and no less than fourteen days before the public hearing, the governing body of the county or city must publish a notice of the hearing in a newspaper of general circulation in the taxing unit; it also must mail a notice of the hearing, by first-class mail, to all property owners and mailing addresses in the proposed development financing district and to the governing body of any special district within which the development financing district is located. The notice must state the time and place of the hearing, specify its purpose, and state that a copy of the proposed plan is available for public inspection in the office of the county or the city clerk. At the public hearing, the governing body of the taxing unit seeking to adopt the plan must hear from anyone who wishes to speak about the proposed district and plan.

After the public hearing, the governing body may adopt the plan, with or without amendment, unless a board of county commissioners or the secretary of the DENR disapproves the plan pursuant to G.S. 158-7.3(f) or (g) or G.S. 160A-515.1(e) or (f). The plan and district *do not*, however, become

effective until the Local Government Commission (LGC) approves the issuance of project development financing bonds for the district.[38]

Approval by the Local Government Commission. A county or city may not issue project development financing bonds without the approval of the LGC.[39] A county or city may file its application to issue the bonds with the secretary of the LGC before it adopts a development financing plan. The application must include all statements of fact and documents required by the secretary concerning the proposed bonds, the development financing district, the development financing plan, and the financial condition of the taxing unit. At the time of application, the governing body must publish notice of the application in a newspaper of general circulation in the county or city.

Before accepting the application, the secretary of the LGC may require representatives of the governing body seeking to issue the debt instruments to attend a preliminary conference. After the application has been filed and after any preliminary conference, the secretary must notify the taxing unit in writing that its application has been filed and accepted for submission.[40] While the LGC may accept the application for issuance of development financing bonds before the development financing plan has been adopted, it may not approve their issuance until the governing body has adopted the development financing plan.[41]

The LGC may consider any matters it deems relevant to whether the bond issuance should be approved, including:

1. whether the projects to be financed from the bonds are necessary to secure significant new project development for the district;
2. whether the proposed projects are feasible (taking into account additional security such as credit enhancement, insurance, or guarantees);[42]
3. the county's or city's debt management procedures and policies;
4. whether the county or city is in default in any debt service obligation;
5. whether the private development forecast in the development financing plan is likely to occur without the public project or projects to be financed by the bonds;
6. whether taxes on the incremental valuation accruing to the development financing district, together with any other revenues available under G.S. 159-110, will be sufficient to service the proposed project development financing debt instruments;
7. whether the LGC can market the proposed project development financing debt instruments at reasonable rates of interest.[43]

The effective date of the development financing district is the date the LGC enters its order approving issuance of the development financing bonds, unless the debt is for a development financing district already in place.[44] As a development financing district is terminated at the earlier of thirty years or the date the bonds are fully satisfied, approval of bonds for a district already in place does not extend the life of the district beyond thirty years.

Defining and Collecting Tax Increment Revenue

Immediately following LGC approval of project development financing bonds, the county or city must notify the county tax assessor of the existence of the district.[45] The tax assessor then determines the base valuation of the district: the assessed value of all taxable property located in the district on the January 1 immediately preceding the effective date of the district[46] plus the value of property acquired by the county or city or its agent within one year before the effective date of the district.[47] If, however, the county or city can demonstrate that it acquired the property primarily for a purpose *other* than to reduce the base valuation of the district, the value of that property will not be included in the base valuation.[48]

After determining the base valuation of the district, the tax assessor must certify the valuation to the taxing unit that created the district, the county in which the district is located if the district was created by a city, and any special district within which the development financing district is located.[49] This base valuation is the frozen assessed value for the district until the next countywide revaluation and is used to establish the incremental tax revenues that will repay the project development financing bonds.

The base valuation of a district may be adjusted if property is added to or removed from a development financing district pursuant to an amendment of the taxing unit's development financing plan.[50] The base valuation also would be increased in revaluation years if property values of the district as they existed on the January 1 immediately preceding the effective date of the district are increased by the revaluation.[51] Thus, the base valuation generally increases in a revaluation year to take into account appreciation in the value of property that was in the district as of January 1 before its creation. The new base valuation does not include the value of improvements to property made after the

January 1 preceding the effective date of the district. A county assessor must immediately certify any amendments to the base valuation of a district to the same entities notified of the initial base valuation.[52]

After establishing a development financing district approved by the LGC, a county or city must establish a revenue increment fund (*special revenue fund*) to account for the proceeds paid to the county or city from taxes levied on the incremental assessed value in the district, including taxes levied based on property owners' agreements to a minimum assessed property value.[53] A *capital projects fund* is used to account for the tax increment bond proceeds and their expenditure for capital improvements.

Each year the county tax assessor determines the current assessed value of property in the project development district.[54] Real property within the district continues to be valued pursuant to the countywide revaluation schedule, which must provide for the revaluation of real property at least every eight years.[55] Personal property within the district (other than registered motor vehicles), like all personal property in the county, is valued as of January 1 of each year.[56] Improvements to real property are added to the tax base on the first January 1 of their existence and are assessed according to the value that would have applied on January 1 of the last revaluation year.[57] Thus, increases in the current assessed value in nonrevaluation years result solely from improvements to property rather than appreciation in market value. Market value appreciation increases the current assessed value only in revaluation years. The incremental value of the development financing district is the current assessed value in a given year minus the base assessed value of the district. In any year in which there is an incremental assessed value, the following steps are taken to distribute the tax proceeds resulting from the application of the county's or city's tax rate to the project development district:

1. The net proceeds are calculated, which represent the gross proceeds less refunds, releases, and any collection fees.
2. The net proceeds from the following taxes are paid to the taxing unit that levied the tax: (a) taxes levied specifically to repay general obligation debt, (b) nonschool taxes levied pursuant to a vote of the people; (c) taxes levied for a municipal or county service district; and (d) taxes levied by a taxing unit in a development financing district established by a different tax unit for which no increment agreement exists.
3. The remaining taxes are multiplied by a fraction in which the base valuation is the numerator and the current assessed valuation is the denominator. The product of this multiplication is retained by the city, county, or special district as if the development financing district did not exist.
4. The remaining proceeds are turned over to the finance officer for the taxing unit that established the district and issued the financing instruments; this official deposits these amounts in the revenue increment fund.[58]

In practical terms, tax increment revenue is established by applying the county's or city's tax rate to the incremental assessed value of the district. If the development financing district includes property conveyed or leased by the taxing unit to a private party in consideration for the increased tax revenue expected to be generated by improvements constructed on the property pursuant to G.S. 158-7.1, then an amount equal to the consideration, less the increased tax revenue realized since the construction of the improvement, must be transferred from the revenue increment fund to the county, city, or special district as if the development financing district did not exist.[59]

Money that remains in the revenue increment fund after any such transfers may be used to (1) finance capital expenditures by the issuing unit; (2) meet principal and interest payments and establish and maintain debt service reserves for project development financing debt instruments and debt instrument anticipation notes issued for the district; (3) repay the appropriate fund of the issuing city or county for moneys expended on debt service for project development financing debt instruments; and (4) meet other requirements imposed by the order authorizing the project development financing debt instruments. If excess funds remain in the revenue increment fund after all voluntary and involuntary purposes have been satisfied, they must be paid to the general fund of the county and, if applicable, the city or special district, in proportion to their rates of ad valorem tax on taxable property located in the development financing district.[60]

An Example of Project Development Financing

Project development financing can be extremely complicated when compared to other financing alternatives, which is why local governments commonly use a negotiated sale rather than a competitive sale when issuing project development bonds. The example presented in this section is not

intended to cover all the details and nuances of project development financing. Its purpose is to show (1) how the amortization of project development bonds is structured according to the projected growth rate of tax increment revenue and (2) how the incremental valuation from a development financing district increases over time.

The city of Bluesky, North Carolina, which is located just outside a major metropolitan area, is negotiating with several developers for projects designed to help revitalize its downtown. One developer is interested in building a hotel and conference facility that will complement Bluesky's close proximity to the interstate and the regional airport that serves the metropolitan area. Another developer is interested in a mixed-use (commercial) project that combines upscale retail space with urban-style apartment homes. The developer pursuing the hotel and conference facility has secured an option to purchase property in downtown Bluesky that currently contains vacant, dilapidated commercial space, which would be demolished to build the new facility.

The developer of the proposed mixed-use project has asked the city to help negotiate the purchase of land adjacent to the site of the proposed hotel and conference facility. The owner of the land does not want to subdivide the parcel, but subdividing the parcel would make it more attractive to the mixed-use project developer. Another issue that complicates both projects is the lack of parking in the downtown area. The hotel developer is willing to build parking spaces to accommodate only hotel guests, but parking would still be problematic for those using the conference center.

One possible solution is for the city of Bluesky to create a development financing district, which would include the parcels of land for the hotel and conference facility and the mixed-use facility. The city could appropriate fund balance to purchase—jointly with the mixed-use developer—the land adjacent to the hotel and conference facility site, which could then be subdivided between the city and the developer. The city could issue project development bonds to build a parking deck on its portion of the property to serve the mixed-use property, the overflow needs of the hotel, and the general public. To ensure that the project development bonds are being used for a public purpose, the city would refrain from guaranteeing spaces to the hotel for its overnight guests.

Assume that after conducting a parking feasibility study to analyze demand based on various rate structures, Bluesky decides to pursue creation of a development financing district. The city completes a development financing plan, which includes the cost of building the parking deck and making necessary street improvements, the sources and amounts of funds to pay for that construction, the base valuation of the development financing district, and the projected incremental valuation that would result from the private investment in the development financing district.

Table 3 contains the amortization schedule for the project development bonds that would finance the proposed parking deck. Bluesky's plan is to issue $12 million in project development bonds at an interest rate of 5.5 percent, with $10.9 million being used for capital projects (parking deck and minor street improvements) and borrowing costs. The remaining $1.1 million will be used to pay for interest on the bonds during the construction phase of the project.[61] The amortization schedule of the project development bonds is based on twenty years.

The base valuation of the property, as shown in Table 3, is approximately $390 million, which increases in Years 8 and 16 as a result of a countywide revaluation. Table 3 shows the projected annual growth rate of the development financing district, the total valuation of the district, the incremental valuation created from annual growth, and the projected property tax revenue based on a city tax rate of 43 cents per $100.

Table 3 also shows general fund revenue during the life of the bonds and the annual tax increment revenue that will be used to amortize the bonds. General fund revenue is calculated by multiplying the fraction of base valuation divided by total valuation against the property tax revenue, as required by G.S. 159-107(d)(2). Annual tax increment revenue represents the difference between property tax revenue and general fund revenue. In practical terms, it approximates the city's tax rate of 43 cents applied to the incremental valuation.

A key element of the amortization schedule is how annual debt service has been structured to accommodate the growth of tax increment revenue. Because tax increment revenue is not sufficient in this case to immediately make annual principal and interest payments, interest-only payments are scheduled for Years 1 through 5. This strategy, along with the $1.1 million of capitalized interest, will ensure that the annual debt payments are satisfied until project construction is completed and tax increment revenue is sufficient to meet annual debt payments. Even with this repayment structure, the projected amount in the revenue increment fund falls to approximately $150,000 in Year 7, as shown in Table 3. Therefore, Bluesky may have to pledge some other source of revenue as additional security for the project development bonds. The city may

Table 3. Amortization Schedule

Capital Projects and Borrowing Costs	$10,900,000
Capitalized Interest	$1,100,000
Total Project Development Bonds	$12,000,000
Interest Rate	5.50%

Year (1)	Base Valuation (2)	Growth Rate (3)	Total Valuation	Incremental Valuation	Property Tax Revenue (4)	General Fund Revenue (5)	Annual Tax Increment Revenue (6)	Annual Principal	Annual Interest	Annual Debt Service Requirement	Outstanding Principal	Tax Increment Revenue Used for Debt Service (7)	Balance in Revenue Increment Fund (8)
1	390,482,000	10.00%	429,530,200	39,048,200	1,846,980	1,679,073	167,907	0	660,000	660,000	12,000,000	0	167,907
2	390,482,000	10.00%	472,483,220	82,001,220	2,031,678	1,679,073	352,605	0	660,000	660,000	12,000,000	220,000	300,512
3	390,482,000	10.00%	519,731,542	129,249,542	2,234,846	1,679,073	555,773	0	660,000	660,000	12,000,000	555,773	196,285
4	390,482,000	8.00%	561,310,065	170,828,065	2,413,633	1,679,073	734,561	0	660,000	660,000	12,000,000	660,000	270,846
5	390,482,000	4.00%	583,762,468	193,280,468	2,510,179	1,679,073	831,106	0	660,000	660,000	12,000,000	660,000	441,952
6	390,482,000	4.00%	607,112,967	216,630,967	2,610,586	1,679,073	931,513	480,000	660,000	1,140,000	11,520,000	931,513	233,465
7	390,482,000	4.00%	631,397,485	240,915,485	2,715,009	1,679,073	1,035,937	480,000	633,600	1,113,600	11,040,000	1,035,931	155,801
8*	429,530,200	12.00%	707,165,184	277,634,984	3,040,810	1,846,980	1,193,830	480,000	607,200	1,087,200	10,560,000	1,087,200	262,432
9	429,530,200	2.00%	721,308,487	291,778,287	3,101,626	1,846,980	1,254,647	480,000	580,800	1,060,800	10,080,000	1,060,800	456,279
10	429,530,200	2.00%	735,734,657	306,204,457	3,163,659	1,846,980	1,316,679	480,000	554,400	1,034,400	9,600,000	1,034,400	738,558
11	429,530,200	2.00%	750,449,350	320,919,150	3,226,932	1,846,980	1,379,952	960,000	528,000	1,488,000	8,640,000	1,488,000	630,510
12	429,530,200	2.00%	765,458,337	335,928,137	3,291,471	1,846,980	1,444,491	960,000	475,200	1,435,200	7,680,000	1,435,200	639,801
13	429,530,200	2.00%	780,767,504	351,237,304	3,357,300	1,846,980	1,510,320	960,000	422,400	1,382,400	6,720,000	1,382,400	767,721
14	429,530,200	2.00%	796,382,854	366,852,654	3,424,446	1,846,980	1,577,466	960,000	369,600	1,329,600	5,760,000	1,329,600	1,015,588
15	429,530,200	2.00%	812,310,511	382,780,311	3,492,935	1,846,980	1,645,955	960,000	316,800	1,276,800	4,800,000	1,276,800	1,384,743
16*	472,483,220	12.00%	909,787,772	437,304,552	3,912,087	2,031,678	1,880,410	960,000	264,000	1,224,000	3,840,000	1,224,000	2,041,153
17	472,483,220	1.00%	918,885,650	446,402,430	3,951,208	2,031,678	1,919,530	960,000	211,200	1,171,200	2,880,000	1,171,200	2,789,483
18	472,483,220	1.00%	928,074,507	455,591,287	3,990,720	2,031,678	1,959,043	960,000	158,400	1,118,400	1,920,000	1,118,400	3,630,126
19	472,483,220	1.00%	937,355,252	464,872,032	4,030,628	2,031,678	1,998,950	960,000	105,600	1,065,600	960,000	1,065,600	4,563,475
20	472,483,220	1.00%	946,728,804	474,245,584	4,070,934	2,031,678	2,039,256	960,000	52,800	1,012,800	0	1,012,800	5,589,931

(1) Revaluation is based on an eight-year cycle as noted by the asterisks.
(2) The base valuation is adjusted by a growth rate of 10 percent in years 8 and 16, resulting from appreciation within the district as determined by countywide revaluation.
(3) The total valuation is adjusted by a growth rate of 12 percent in years 8 and 16, resulting from appreciation (countywide revaluation) and additions within the district.
(4) Property tax revenue produced from total valuation is based on a tax rate of 43 cents per $100 taxable value.
(5) General fund revenue is the product of multiplying the fraction of base valuation divided by total valuation against property tax revenue.
(6) Annual tax increment revenue represents the net proceeds of property tax revenue minus general fund revenue.
(7) The capitalized interest of $1,100,000 is used to pay the first year's annual debt service payment (interest only) of $660,000. The balance of $440,000 at the end of year one is applied against the second year's annual debt service payment (interest only) of $660,000.
(8) Any money remaining in the revenue increment fund after all purposes have been satisfied is returned to the general fund on an annual basis as required by G.S. 159-107(f).

government sales tax proceeds as additional security.

Figure 1 shows how the projected incremental valuation increases over the twenty-year period that represents the lifetime of the bonds. The incremental valuation in the development financing district is projected to increase by approximately $200 million in the first six years of its existence due to the new development projects. The importance of viable development projects cannot be overstated, given the growth rates required to create a substantial incremental valuation in the early years of development financing districts. The city may ensure a minimum level of incremental valuation by entering into agreements with developers, setting a minimum assessed value for proposed improvements in the district.

Figure 1 shows that the valuation is projected to increase by another $300 million over the next fourteen years. Slower growth is estimated after the first few years of the development financing district's existence because of the difficulty of predicting future development. The base valuation is adjusted in Years 8 and 16 (as shown in Figure 1), a result of appreciation within the district as determined by the countywide revaluation. If the development financing district ends after the bonds are satisfied in Year 20, Figure 1 also shows how project development financing would have achieved positive economic growth in Bluesky's downtown area by increasing the district's total valuation from approximately $400 million to over $900 million.

Conclusion

Project development financing provides counties and cities in North Carolina with a new method of financing joint public and private ventures designed to combat blight and promote economic and community development. While the funding of such projects through project development financing may not be feasible for all urban renewal and economic development projects and is unlikely by itself to eradicate blight or generate long-term financial prosperity for a specific area, this financial tool may be utilized to spark, and subsequently complement, other revitalization and development efforts. Careful planning and in-depth financial analysis are prerequisites to the success of a project development financing endeavor.

County or city officials proposing to create a development financing district must ensure that the issuance of debt for public infrastructure is necessary to achieve their renewal goals and recognize that the desired private investment will not occur without public resources. Before establishing such a district, a local government also will need to consider what, if any, revenues in addition to the tax increment must be pledged to guarantee the bonds. The Project Development Financing Act provides counties and cities with a fair amount of flexibility in determining the projects in which to invest public funds as well as the manner in which to structure and guarantee repayment of project development financing debt. It remains to be seen whether, and how, these debt instruments will contribute to the rebuilding and growth of North Carolina communities.

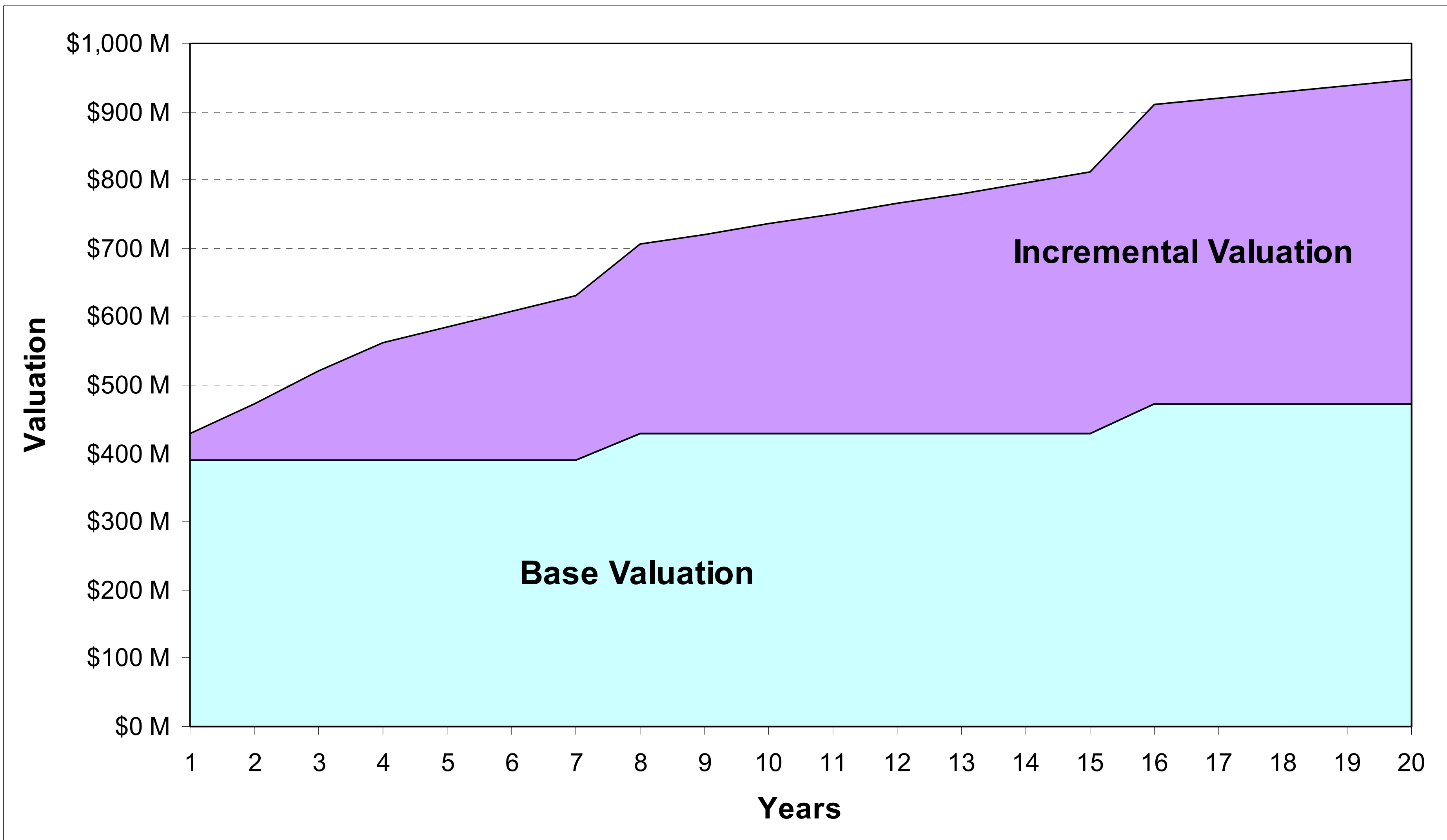

Figure 1. Increase in Valuation

Notes

1. A. Fleming Bell II and David M. Lawrence, "Local Government and Local Finance," in *North Carolina Legislation 2003*, ed. William A. Campbell (Chapel Hill, NC: School of Government, University of North Carolina at Chapel Hill, 2003), 123.
2. S.L. 2003-403.
3. For a general discussion on tax increment financing, see David Hitchcock, "CreaTIFity Helps Cities Find Development Dollars," *American City and County* 110 (May 1, 1995): 40–46.
4. John P. Blair, *Urban and Regional Economics* (Boston: Irwin, 1991).
5. Deborah A. Carroll, "Assessing the Impact of Tax-Exempt Properties in TIF," *Journal of State Taxation* 22, no. 2 (2003): 62–75.
6. Josephine M. LaPlante, "Who Uses Tax Increment Financing? Local Government Adoption Catalysts," *Municipal Finance Journal* 22 (Spring 2001): 78–97.
7. N.C. GEN STAT. § 159-111 (hereinafter G.S.).
8. G.S. 159-108.
9. G.S. 159-108(c).
10. Deborah A. Carroll, "Assessing the Impact of Tax-Exempt Properties in TIF," *Journal of State Taxation* 22, no. 2 (2003): 62–75.
11. G.S. 159-107(b), (g).
12. G.S. 159-107(f).
13. Ann M. Cox, Morgan M. Mundell, and Thomas G. Johnson, "A Dynamic Simulation of TIF Impacts on Multiple Jurisdictions," *Municipal Finance Journal* 22 (Spring 2001): 11–40.
14. Kenneth A. Kriz, "The Effect of Tax Increment Finance on Local Government Financial Condition," *Municipal Finance Journal*, 22 (Spring 2001): 41–64.
15. Joyce Y. Man, "The Impact of Tax Increment Financing Programs on Local Economic Development," *Journal of Public Budgeting, Accounting and Financial Management* 11 (Fall 1999): 417–30.
16. N.C. CONST. Art. V, Sec. 4 (stating general rule and setting forth limited exceptions).
17. G.S. 105-283; -284.
18. G.S. 159-102, -103.
19. Proceeds also may be used for any service or facility authorized by G.S. 160A-536 and provided in a municipal service district. G.S. 159-03.
20. *Id*.
21. *Id*.
22. *Id*.
23. G.S. 159-103(a) (permitting expenditures for only selected purposes set forth in G.S. 159-48 and excluding other purposes).
24. G.S. 158-7.3(b), (c).
25. G.S. 158-7.3(c).
26. G.S. 158-7.3(a)(1).
27. A development tier one area is a county whose annual ranking, based on its development factor, is one of the forty highest in the state. A county's development factor is the sum of its ranking among other counties by average rate of unemployment (from lowest to highest), median household income from highest to lowest, percentage growth in population from highest to lowest, and adjusted assessed property value per capita from highest to lowest. Counties with populations of less than 12,000 also are automatically ranked as one of the forty highest counties, along with any county with a population of less than 50,000 and with more than 19 percent of its population below the federal poverty level. G.S. 143B-437.08.
28. G.S. 158-7.3(c); 160A-515.1(b).
29. G.S. 158-7.3(b); 160A-515.1(b).
30. G.S. 158-7.3(c).
31. G.S. 158-7.3(d); 159-107(e).
32. G.S. 158-7.3(b); 160A-515.1(a).
33. G.S. 158-7.3(d); 160A-515.1(c).
34. G.S. 158-7.3 (g); 160A-515.1(f).
35. G.S. 158-7.3(f); 160A-515.1(e).
36. *Id*.
37. G.S. 158-7.3(h); 160A-515.1(g).

38. G.S. 158-7.3(h); 160A-515.1(g).
39. G.S. 159-104.
40. *Id*.
41. *Id*.
42. A county or city may pledge or grant a security interest in any of its available sources of revenue, including special assessments against property within the development financing district, as long as doing so does not constitute a pledge of the unit's taxing power (G.S. 159-111(b)). Because local option sales tax revenue results from the taxing power of counties, cities, but not counties, may pledge sales tax revenues as security for repayment of project development financing bonds. A. Fleming Bell II, David M. Lawrence, and Aimee Wall, "*Local Government and Local Finance*," in *North Carolina Legislation 2005*, ed. Martha H. Harris (Chapel Hill, NC: School of Government, University of North Carolina at Chapel Hill 2006), 180. A county or city also may enter into covenants to take action to generate pledged revenues, again as long as those agreements do not constitute a pledge of the taxing power (G.S. 159-111(b)). Counties and cities may pledge, mortgage, or grant a security interest in the real and personal property financed or improved with the proceeds of the project development financing bonds. (G.S. 159-111(b)). Property subject to such a mortgage, deed of trust, security interest, or similar lien may be sold at foreclosure in any manner permitted by the instrument creating the encumbrance (G.S. 159-111(b)).
43. G.S. 159-105(a). See also G.S. 159-105(b) (establishing the criteria used by the LGC to approve proposed project development financing bonds).
44. G.S. 159-106(b).
45. G.S. 159-107.
46. G.S. 159-107(a).
47. Property owned by counties and cities is exempted from taxation pursuant to G.S. 105-278.1 and Article V, Section 2(3) of the state constitution.
48. *Id*.
49. *Id*.
50. G.S. 159-107(b).
51. *Id*.
52. G.S. 105-107(b).
53. G.S. 105-107(c).
54. G.S. 159-107(d).
55. G.S. 105-286.
56. G.S. 105-285. Registered motor vehicles are valued as of January 1 of the year the taxes are due. G.S. 105-330.2.
57. G.S. 105-287.
58. G.S. 159-107(d)(2).
59. G.S. 159-107(f) specifies how moneys in the revenue increment fund can be used.
60. *Id*.
61. Rules for reporting capitalized interest differ between governmental and proprietary funds.

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