Applying Tax Increment Financing in the Charlotte-Mecklenburg Region

A study by
the Center for Real Estate at UNC Charlotte and
the UNC Charlotte Urban Institute

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Introduction, Purpose & Study Design

This report presents the results from Phase I of a study on Tax Increment Financing ("TIF") in North Carolina conducted by the UNC Charlotte Center for Real Estate and the UNC Charlotte Urban Institute, with collaboration from the faculty of the Political Science Department, and with funding from the Crosland Foundation. Principal investigators were Steve H. Ott, Ph.D., of the Center for Real Estate, Vicki Bott, of the Institute, and Gary Rassel, Ph.D., of the Political Science Department.

In November, 2004, the citizens of North Carolina approved an amendment to the state constitution that enabled for the first time the use of tax-increment financing in the state. North Carolina became the 49th state to permit the use of this public financing tool that allows bond debt from public investments in infrastructure and other public facilities development to be secured by the increase in tax revenue anticipated from private development spurred by those public investments. While the legislation uses the term "project development financing", the simpler term "TIF" is used in this document.

In an attempt to better understand how TIF might be used in NC, and to lessen the learning curve for a tool that is new to NC, this study was designed to explore how the Charlotte region might best use TIF. A primary goal of this study is to enhance the readiness of the region's public finance officers, economic development commissions, and real estate developers to use TIF, by providing them with:

a) basic aspects of TIF under NC's new laws,

b) some practical guidelines for setting up TIF districts, and

c) a more in-depth examination of the economic and land use factors that influence the feasibility of a range of potential TIF-supported development projects.

A second critical component of the project is the development and application of an economic model to assess various TIF scenarios on the speed with which and degree to which the development projects produce increased property values and tax revenues.

The project is in two phases. Phase I includes a review of the national experience with TIF and a summary of resources available in NC for establishing TIF districts, as well as the results of a national survey on TIF usage, a statewide survey on TIF prospects and regional interviews on TIF with key practitioners. It also includes the building of the economic model for assessing TIF scenarios, and the involvement of key stakeholders from the region in identifying the kinds of development projects to be used as hypothetical TIF scenarios for the model runs. Phase II will include gathering site-specific data for the TIF scenarios, running the model, and sharing the results with key stakeholders from the region.

The authors of this report wish to thank the Crosland Foundation for its generous support of this study.

Review of Existing TIF Research

Tax increment financing provides local governments with a means of encouraging economic development that would not occur without assistance from the public sector. A number of unique public-private partnerships have resulted from this technique and use continues to grow throughout the country.

Despite these successes, academic research suggests TIF is not appropriate in all circumstances. Public opposition may arise when it is used in areas likely to experience economic development without subsidization. Additionally, TIF may not result in the anticipated subsidy when used in severely underdeveloped areas or rural areas unlikely to experience significant property value appreciation after the public sector investment.

Many of these concerns can be mitigated by implementing carefully designed projects in *moderately disadvantaged* urban neighborhoods. These areas are often most capable of substantial growth through a limited investment in public infrastructure. Best practices include:

- Limit financing costs by ensuring TIF projects are well planned and financially attractive to the municipal bond market.
- TIF districts should be carefully chosen to:
    i. focus on moderately disadvantaged urban neighborhoods that are likely capable of substantial growth and property value appreciation through a limited investment in public infrastructure;
    ii. avoid areas that are unlikely to experience sufficient property value appreciation to repay the TIF bonds, such as severely blighted urban areas and rural areas that have little to no growth pressures; and,
    iii. avoid areas that would likely experience growth and development without the public subsidy, such as areas on the urban fringe with plenty of vacant land, or urban areas that are not disadvantaged.
- Municipal TIF projects should only be undertaken with the approval of counties and other overlying tax jurisdictions, and should not be used to inappropriately capture tax revenues from counties or other tax jurisdictions without their agreement.
- Hold TIF projects to the same standards as other forms of public-private partnerships, including conforming to the community's master plan and enhancing the public good; avoid projects lacking extensive public support, especially those failing to pass a previous bond referendum.

Regional Stakeholder Interviews

In the process of developing a guide to Tax Increment Financing (TIF) and designing hypothetical TIF districts for economic modeling, informational interviews were conducted to gather information from professionals who are or were likely to be directly involved with TIF. These key practitioner interviews were held with various stakeholders, including government financing specialists, government and private economic development specialists, real estate attorneys and real estate development

professionals in the greater Charlotte region. We assumed that some, and perhaps all, of these stakeholders were active supporters of the constitutional amendment authorizing TIF and that many would be evaluating potential TIF projects.

The interviews provided much helpful insight into current perceptions of TIF and intent to use TIF. The interviews indicated that TIF is considered to be a valuable tool for use in certain situations and areas. As illustrated by the data presented, including pros, cons, suggestions, examples, and potential projects, TIF may be more advantageous to larger towns and cities, or counties with non-industrial projects, and it may be a better fit for stable, low debt communities. Should a jurisdiction be near its general obligation debt limit, however, TIF may provide a tool for economic development that is otherwise not available. The North Carolina legislation, as written, prescribes a conservative approach to using TIF. Many interviewees indicated that although NC's TIF laws were intended to prevent many of the problems seen in other states, they also include requirements that may limit TIF use by jurisdictions in North Carolina.

Recent Survey Data on Tax Increment Financing

Two recent surveys provided information on tax increment financing. The first was a 2004 national survey of the economic development activities of a sample of cities and counties. It showed that TIF was the second most commonly used source of revenues for economic development, after general fund revenues. General obligation and revenue bonds were not used often to support economic development efforts. North Carolina local governments also fund economic development from general fund revenues. TIF projects may prove to be an alternative to these resources rather than an alternative to general obligation bonds.

This survey also showed that TIF use was most prevalent in the states in the Midwest and West Coast and least prevalent in states in the Northeast. Of the states neighboring North Carolina, local governments in South Carolina were most likely to have used TIF. Other characteristics of likely TIF users are cities in the population range of 25,000 to 100,000 with lower per capita incomes and lower per capita property tax revenues. TIF users are less likely to use a range of local taxes than are non TIF jurisdictions. Since North Carolina has many local governments within this population range, they cannot use local income taxes and personal property taxes are limited, the interest in TIF in North Carolina may follow this national course. The survey data appear to show that local governments using tax increment financing are more involved in economic development efforts than are those who do not use TIF. Those governments using TIF also are more likely to use a range of other tools.

The second of the two surveys was of a sample of economic development specialists, finance officers, and planners representing local governments in North Carolina. It was conducted in April of 2006 and obtained information on respondents' plans for using TIF. Although only one TIF project had been approved by June of 2006, interest in tax increment financing seems to be strong in North Carolina local governments. Seventy percent of the respondents had looked into this form of financing economic development, fifteen percent were seriously considering TIF for a project, and an additional ten percent had begun or completed the process of identifying a TIF district. Twenty-six percent of

the respondents to the state survey reported they may attempt to use TIF with the next two years.

As local officials and the public become more familiar with TIF and the procedures for using it, its use may become common. Although respondents noted that the lengthy process for obtaining TIF approval and public perception were major barriers to its use, a majority rated it an effective tool for local governments in North Carolina to use for economic development. A few demonstrated successes may lead to its full consideration.

NC TIF Process and Resources

Many of the lessons from other states' experience with TIF have been incorporated in North Carolina's TIF laws enacted in 2004. A multi-step process is prescribed for state approval of TIF bonds that includes specific requirements for designation of TIF district boundaries and adoption of a written TIF plan, and limitations on types of projects that can be funded using TIF. NC requires counties to review municipal TIF projects, allows them to choose whether or not to participate in financing those projects (i.e., relinquishing of incremental tax revenues,) and allows them to veto municipal TIF projects even if they choose not to participate in financing.

A distinctive feature of NC TIFs is that they come in two forms. The first, "development" TIF projects, are permissible to both counties and municipalities. The second, "redevelopment" TIF projects, integrate with the existing NC Urban Redevelopment Act, and may be used by municipalities either alone or with counties, but may only be used by counties when done jointly with municipalities. Development TIFs are more restricted in the type of project that may be undertaken (e.g., new jobs creation requirements and limits on retail floor space), while redevelopment TIFs are more restricted in the type of area they may be used in (e.g., required findings of blight.)

There are seven (7) basic steps to using TIF in NC:

1. Consult with the NC Local Governments Commission
2. Define the TIF district boundaries ("the Development Financing District")
3. Develop a TIF Plan ("Development Financing Plan"):
    - Define the public investment: nature of the project, detailed costs, sources and amount of funds to pay for the public investment, and term for proposed TIF bonds
    - Describe the anticipated private development
    - Define TIF District's boundaries and base tax revenue, and estimate the anticipated tax increment
    - Describe benefits of the public and private development to TIF District residents and business owners
    - Describe activities to ameliorate potential negative impacts of the project to TIF District residents and business owners
    - Stipulate compliance with statutory manufacturing wage requirements.

4. Request external reviews:
    - County Commission must review and can veto municipal-sponsored TIF Plans
    - NC DENR (Department of Economic and Natural Resources) reviews TIF Plans for environmental impacts of manufacturing
    - NC DOC (Department of Commerce) reviews TIF Plans for manufacturing wage test
5. Hold a Public Hearing, Pass a "but for" resolution, & Adopt the TIF Plan
6. Submit a TIF Application to the NCLGC (Local Government Commission) for TIF Bond Issuance Approval
7. If approved:
    - Notify the County Tax assessor to set the base tax valuation
    - Establish a Tax Revenue Increment Fund
    - Produce annual TIF reports

The full report provides more detailed guidance on the legal requirements for using TIF in NC, a comparison of TIF with existing public finance tools, and a list of additional resources for using TIF in NC.

TIF Economic Model

As part of this phase of the study, the researchers have developed a model that assesses the economic efficiency of a TIF proposal. For the government's TIF investment to be economically efficient, i.e., wealth enhancing to the citizens, the following must hold:

The present value of the increase in property taxes after the TIF investment

minus

the present value of the increase in property taxes that might occur without the investment

must be greater than

the TIF investment.

Thus, in order to determine the economic feasibility of the government's investment in a TIF district (or for an individual TIF project), the model must carefully and realistically examine the economics of the private real estate market in which the project resides and the developers' economic decision making-process given this market. The TIF investment must be such that the private market responds adequately with construction, leasing and sales that can be expected to increase incremental tax revenues within the district.

For a given project or district, the model developed by the researchers determines the expected amount, value, and timing of construction and sales activity, which then translates into a property tax cash flow stream over time. This analysis is done for the area or project both with *and* without the TIF investment. The incremental difference in

the property tax cash flows is then compared to the debt service on the TIF bonds to see if the investment is economically viable and that the bonds can be timely paid.

The full report contains a list of the model's input and output data variables, as well as the complete technical definition of the model.

TIF Scenarios

In addition to legal criteria required by the North Carolina General Statutes, the researchers have drafted other criteria for structuring a successful TIF program, that can be used both for designing the TIF scenarios for economic modeling anticipated in Phase II of the study, and by local governments as a guide in using TIF. These criteria are drawn from the review of other states' experience with TIF and from the stakeholder interviews with local economic developers, lawyers, and local government officials. The resulting criteria fall into three categories: those related to the local government Sponsor, those related to selecting appropriate Sites or Areas for TIF districts, and those related to the actual TIF Projects themselves. See the full report for a complete listing of criteria.

Stakeholder Workshop

A stakeholder workshop was held on June 27, 2006 at the UNC Charlotte Uptown Center to present the findings from the first phase of the study and to gain participant feedback that was used to refine the final report. Attending were approximately sixteen professionals from various sectors, including non-profits, real estate, government, and legal. In addition, three roundtable members participated who had reviewed the preliminary study findings in advance. The format of the workshop was "present and discuss" where the researchers presented their findings, then the roundtable members posed questions and offered comments. After the roundtable members responded to the presentations, the floor was opened to attendees for questions and comments.

About half of the attendees indicated that they had not previously been exposed to information about TIF in NC. Questions and comments from the roundtable members and attendees were in roughly equal parts aimed at helping identify areas needing clarification in the report, and in exploring nuances of TIF application in NC. Highlights of the discussion can be found in the full report, and include information about synthetic TIF, clarification of the distinction between development TIF and redevelopment TIF, the viability of residential TIF projects, and suggestion of a statutory change to replace the sampling of G.O. Bond permitted purposes with a list of permitted purposes tailored for TIF only.

Conclusions & Next Steps

When carefully and appropriately used, TIF can be a useful economic development and public financing tool. It allows local governments to control the development process for areas that otherwise would likely not receive needed private sector investment in economic development. It provides them with a means of funding the public portion of the economic development investment that neither raises the general property tax rate nor requires a ballot referendum.

The lower-than expected volume to date of TIF applications to the NC Local Government Commission appears to be explained by a combination of the factors anticipated by this study:

- The learning curve for using TIF is steep:
  - the NC approval process is perceived as uncertain and complex;
  - TIF is an inherently riskier tool than many other public financing tools, making reliable evaluation of TIF feasibility a critical capability that NC governments must acquire (through tools such as economic models and through expertise either internal or in hired consultants); and
- Not all projects will prove to be a good fit for TIF, and some projects may be a better fit for the alternative financing tools that have grown up in the absence of TIF.

These factors suggest that TIF usage in NC will naturally increase over time as the first few projects emerge from the NC TIF process and local governments and the private sector gain experience in navigating that process, determining TIF "fit", and in assessing TIF feasibility.

The results of the first phase of this study should assist with this process. The economic model developed by the researchers in this first phase of the study may prove to be a significant aid in assessing feasibility, while the NC TIF Process guidelines developed in this study should provide a useful first step towards determining TIF fit and navigating NC's process.

There are also some changes to the NC TIF laws that could enhance TIF usage in North Carolina:

- Replace the mix of TIF permitted uses currently drawn from existing General Obligation Bond permitted uses with a TIF-specific list of permitted uses.
- Examine whether a standard for small jurisdictions other than the current 5% of total land area cap on TIF districts is appropriate.
- Remove the manufacturing wage test requirements.
- Clarify the distinctions and similarities between "development" and "redevelopment" TIF projects to improve comprehensibility.

Based on the results of the first phase of the study, the researchers intend to proceed with the second phase of the study in which specific potential TIF projects (or "scenarios") will be evaluated using the economic model developed in Phase I. In addition to securing additional funding to allow completion of the study, Phase II will involve these major components:

A. Select scenarios for economic model testing

B. Gather scenario data required as input to economic model

C. Conduct economic model runs

D. Assess results of scenarios economic modeling

E. Present results at regional stakeholder workshop and gain stakeholder feedback

F. Document and publish final study results

I. Introduction, Purpose and Study Design

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In November, 2004, the citizens of North Carolina approved an amendment to the state constitution that enabled for the first time, the use of tax-increment financing ("TIF") in the state. Through its "Project Development Financing Act", North Carolina became the 49th state to permit the use of this public financing tool that allows bond debt from public investments in infrastructure and other public facilities development to be secured by the increase in tax revenue anticipated from private development spurred by those public investments. While the legislation uses the term "project development financing", the simpler term "TIF" is used in this document.

Since TIF legislation was actually passed in the summer of 2003 but not effective until the November 2004 ratification of the amendment, many observers had expected a wave of TIF projects to follow in 2005. But, by the spring of 2006, only one TIF proposal had been submitted to the state, and no other TIF plans had been publicly announced. Several possible explanations offered themselves: the learning curve for using TIF is steep; the availability of alternative financing tools that had grown up in the absence of TIF are "better" tools than TIF, or at least, better understood than TIF; the NC law authorizing TIF limits its applicability and/or the approval process is perceived as uncertain; and, TIF is an inherently riskier tool than many other public financing tools, making NC's relatively conservative and cash-strapped local governments hesitant to embrace TIF.

In an attempt to better understand how TIF might be used in NC, and to lessen the learning curve for a tool that is new to NC, this study is designed to explore how the Charlotte region might best use TIF. A primary goal of this study is to enhance the readiness of the region's public finance officers, economic development commissions, and real estate developers to use TIF, by providing them with a) a grounding in basic aspects of TIF, b) some practical guidelines for setting up TIF districts, and c) a more in-depth examination of the economic and land use factors that influence the feasibility of a range of potential TIF-supported development projects. A second critical component of the project is the development and application of an economic model to assess various TIF scenarios on the speed with which and degree to which the development projects produce increased property values and tax revenues.

The project is in two phases. Phase I includes a review of the national experience with TIF and a summary of resources available in NC for establishing TIF districts, as well as the results of a national survey on TIF usage, a statewide survey on TIF prospects and regional interviews on TIF with key practitioners. It also includes the building of the economic model for assessing TIF scenarios, and the involvement of key stakeholders from the region in identifying the kinds of development projects to be used as

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II. TIF: Review of Existing Research

A. Introduction

Evolving economic conditions have encouraged local governments to become increasingly involved in economic development. Capital mobility has provided firms with the ability to relocate in search of more profitable locations and many communities have found financial subsidies necessary to compete.[1] However, local resources have been strained by reductions in federal and state economic development funding, as well as resistance to local property tax increases.[2] North Carolina responded to these challenges in 2004 by approving the North Carolina Project Development Financing Act.[3] The legislation allows local governments to issue self-financing bonds to provide an alternative source of revenue to support economic development.

The use of self-financing bonds is commonly known as tax increment financing (TIF) in other jurisdictions and will be referred to as such throughout the following study.

TIF has emerged as an effective means of generating economic development funding and its use has expanded dramatically since its initial adoption by California in the early 1950s.[4] North Carolina legislation made it the forty-ninth state to authorize the public finance technique and research suggests use continues to grow.[5]

Enabling legislation authorizing the use of TIF varies from state to state, but several common features are outlined throughout the public finance literature. TIF generally involves the capture of property tax revenues to fund economic development. Some states allow the capture of other types of taxes, but property tax TIF is the most common. The remainder of the literature review will focus exclusively on these programs. [6] The municipality first identifies a geographic boundary for the TIF district. Many states require the TIF district to encompass a blighted area and include statutory language

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[1] Arvidson, Enid, Rod Hissong, and Richard L. Cole. 2001. Tax Increment Financing in Texas: Survey and Assessment. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press. 155-178.

[2] Klemenski, John S. 1989. Tax Increment Financing: Public Funding for Private Economic Development Projects. *Policy Studies Journal*. 17:3, 656-671.

[3] N.C. Gen. Stats. Ann. § 159-48. (2006).

[4] Man, Joyce Y. and Mark S. Rosentraub. 1998. Tax Increment Financing: Municipal Adoption and Effects on Property Value Growth. *Public Finance Review*. 26:6, 523-547.

[5] Lucas, Lucas C.T., and Brenton D. Jeffcoat. 2004. North Carolina Project Development Financing. Report prepared for the North Carolina Local Government Commission. Klacik, Drew J. 2001. Tax Increment Financing in Indiana. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press. 179-192. Between 1989 and 1995, use of TIF financing quadrupled in Indiana.

[6] Mikesell, John L. 2001. Nonproperty Tax Increment Programs for Economic Development: A Review of the Alternative Programs. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press. 57-69. California, Colorado, Washington D.C., Illinois, Indiana, Kansas, Louisiana, Missouri, and Wyoming all allow the capture of sales tax revenues. Maine's Employment Tax Increment Financing program even includes state individual income taxes, employment taxes, and payroll taxes.

limiting use to areas where economic development would not occur "but for" economic development subsidies. After defining the geographic scope of the project, the existing property tax base within the TIF district is calculated and "frozen" at the current level. The general property tax rate continues to apply to the frozen tax base throughout the life of the TIF. Property tax revenues are apportioned to the local government sponsoring the TIF and all overlying tax jurisdictions according to existing tax rates.

Public investment is then made within the TIF district to promote development or redevelopment efforts. TIF investment often involves improvement of public infrastructure necessary to support economic development. Water and sewer system expansion, road construction, and provision of green space are common TIF investments designed to enhance the attractiveness of an underdeveloped area. Private real estate developers indirectly benefit from these improvements. TIF funding may also be used to directly support a specific development project by subsidizing land assemblage, site preparation, demolition, and structured parking costs.[7] Overall, the public investment is designed to spur economic development and increase the property tax base within the TIF district.

As property values increase, the general property tax rate is applied to the expanding tax base within the TIF district. The increase in property tax revenues after creating the TIF district is defined as the "tax increment". The tax increment is retained exclusively by the municipality establishing the TIF and is not distributed amongst overlying tax jurisdictions, such as the county and school district. The tax revenues diverted to the TIF sponsor are then used to repay bond debt issued to finance the initial public investment. The TIF district expires after the bonds are repaid and all property tax revenues are once again distributed among all taxing jurisdictions.

This type of tax increment financing has become very popular among local governments suggesting it provides a competitive advantage in economic development activities. However, the prevalence of TIF projects also raises questions regarding the economic consequences for sponsoring governments and overlying tax jurisdictions. The following literature review addresses these questions. Section II begins by outlining the potential positive and negative consequences of TIF and the underlying economic theory. Section III provides an overview of existing empirical research addressing the validity of these concerns. Section IV identifies a number of best practices designed to limit negative consequences of TIF. Finally, Section V provides a brief summary and concluding remarks.

B. The Potential Benefits and Burdens of TIF

1. Benefits

The structure of tax increment financing potentially provides a community with a number of benefits. First, TIF may allow local governments to engage in socially desirable

[7] Klacik (2001) at 185.

economic development projects that would not be undertaken without subsidization (Huddleston, 1981).[8] By diverting property tax revenues to a TIF sponsoring government, the technique may provide an equitable means of compelling overlying tax jurisdictions to contribute to economic development projects in an amount proportional to the property tax revenues they stand to benefit from in the future.[9]

Second, TIF projects may be more politically viable than other options. Local governments retain control of economic development decisions (Williams, 1996)[10] and can avoid the bureaucratic requirements of intergovernmental aid (Davis, 1989).[11] Creation of a TIF district does not require voter approval and is not limited by general obligation bond restrictions (Sullivan, 2002 and Royse, 1992).[12] Local property tax rates may not need to be increased to provide economic development funding if increased property tax revenues are sufficient to cover the cost of the TIF investment (Stinson 1992).[13] TIF investment in infrastructure improvements may also be less politically contentious than other forms of subsidization directly benefiting industry.

Third, Brueckner (2001) discussed the difficulties of funding geographically targeted economic development solely with local property tax revenues.[14] Improving infrastructure presumably increases property values throughout the targeted area and the city benefits from a larger property tax base. The enlarged tax base may be sufficient to offset the cost of the infrastructure improvements. However, an increase in the municipal property tax rate may be required if the increased property tax base is not sufficient to cover the entire cost of the public investment. Property owners outside the affected area are likely to oppose the tax increase because they do not benefit from a corresponding increase in public services. These owners may also suffer a decrease in property value as the tax burden is capitalized into real estate prices. TIF potentially allows a city to avoid increasing the local property tax rate by capturing incremental tax revenues from overlying tax jurisdictions.

Fourth, the tax increment financing process may encourage effective public-private interaction and careful project design. A municipality remains involved throughout the development process and can help maximize the public benefits created by a project (Klacik). [15] High private/public investment ratios suggest TIF does generate significant

[8] Huddleston, Jack R. 1981. Variations in Development Subsidies Under Tax Increment Financing. *Land Economics*. 57:3. 373-384.
[9] Id. at 373.
[10] Williams, Curtiss L. 1996. Some Strengths and Weaknesses of Tax Increment Financing. *Economic Development Review*. Winter, 73.
[11] Davis, Don. 1989. Tax Increment Financing. *Public Budgeting and Finance*. Spring, 63-73.
[12] Sullivan, Gary L., Steven A Johnson, and Dennis L. Soden. 2002. Tax Increment Financing Best Practices Study. Institute for Policy and Economic Development. University of Texas at El Paso. Study prepared for the Greater El Paso Chamber of Commerce. Royse, Mark. 1992. Advantages and Disadvantages of Tax Increment Financing. *Economic Development Review*. Spring, 84-86.
[13] Stinson, Thomas F. 1992. Subsidizing Local Economic Development through Tax Increment Financing: Costs in Nonmetro Communities in Southern Minnesota. *Public Studies Journal.* 20:2, 241-248.
[14] Brueckner, Jan K. 2001. Tax Increment Financing: A Theoretical Inquiry. *Journal of Public Economics*. 81. 821-343.
[15] Klacik (2001) at 189-190.

cooperation between these sectors.[16] Bond investors also provide an additional level of scrutiny. Proposed developments must prove feasible in order to attract capital in the municipal bond market.[17] Most importantly, tax increment financing may provide an effective economic development tool. Many local governments have successfully used the tool to attract industry, retain jobs, and expand the municipal tax base (Man, 2001).[18]

2. Burdens

While the potential benefits are numerous, TIF has not gone without criticism. Economists and policy analysts have suggested TIF may be an expensive, inequitable and ineffective means of financing economic development. The structure of TIF also creates an opportunity for misuse by municipal governments attempting to inappropriately capture tax revenues from other tax jurisdictions. These concerns and their theoretical foundations are widely discussed throughout the public finance literature.

a. Expense of Tax Increment Financing

Tax increment financing may be an expensive method of financing economic development projects. Transaction costs such as legal fees, feasibility studies, and insurance costs can be significant (Royse 1992).[19] Debt service costs of TIF may also be higher than traditional public finance techniques (Johnson 2001).[20] Unlike general obligation bonds, many times TIF bonds are not backed by the full faith and credit of the issuing government. The bond investor must look solely to incremental tax revenues generated within a defined geographic area to repay the debt. TIF bonds are potentially risky because there is no guarantee property values will increase within the TIF district after the public investment is made. To compensate for an increased level of risk, investors may require a higher interest rate from TIF bonds than general obligation bonds.

A local government might be willing to accept the higher debt service costs associated with TIF bonds if it is able to avoid the financial risk of general obligation bonds. However, the risk premium may not be economically justified because TIF bonds often carry an "implicit moral backing" of the issuing government.[21] Municipalities are likely to step in and cover debt service payments in the event the tax increment is insufficient, even if they are not legally obligated to do so. The action is taken because failure to

[16] See Wilcox, David A. and David E. Versel. 1999. Review of Best Practices for Tax-Increment Financing in the United States. Economic Research Associates Issue Paper. TIF projects often generate private/public investment ratios as high as 20:1.
[17] Klacik (2001).
[18] Man, Joyce Y. 2001. Introduction. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press. 1-11.
[19] Royse (1992) at 85.
[20] Johnson, Craig L. 2001. The Use of Debt in Tax Increment Financing. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press. 71-86.
[21] Id. at 82.

repay TIF bond debt can presumably have an adverse impact on the municipality's credit rating and increase its cost of general obligation bond debt.[22]

b. Economic Development Bidding Wars

The potentially high cost of tax increment financing is not the only economic concern. Critics of economic development subsidies contend tax increment financing and other programs result in a zero-sum game (Man, 2001).[23] One community achieves economic growth at the expense of another community. Public funds are expended on projects that create no *net* growth in the economy. This issue is especially problematic when TIF is used in economic development bidding wars between two communities within the same overlying tax jurisdiction.[24] The "losing" government not only misses an opportunity to expand its economic base, but also subsidizes the relocation of industry to an adjacent community.

c. Achievement of Policy Objectives

Tax increment financing legislation is often adopted to provide local governments with an economic development tool designed to address urban blight.[25] Unfortunately, a number of factors may undermine this policy objective. Huddleston (1981) showed TIF does not create the same intergovernmental subsidy for all communities.[26] The subsidy rate is the percentage of the economic development expenditure paid by government entities other than the TIF sponsoring government. The size of the subsidy rate depends upon the local government's property tax rate and their proportionate share of the property tax base compared to other contributing tax jurisdictions involved in the project. Cities which make up a small portion of the overlying tax jurisdiction and have low local property tax rates receive larger TIF subsidy rates. TIF may not focus economic development within blighted urban areas if greater financial incentives are provided to suburban communities. An examination of TIF subsidies in Wisconsin found small cities would receive a subsidy rate two times higher than the state's largest cities.[27]

Huddleston (1984) continued the analysis by comparing TIF subsidy rates with a community's population growth rate and state aid payments designed to address fiscal disparities.[28] The study found Wisconsin communities experiencing population growth were generally provided with a greater subsidy rate through tax increment financing.[29]

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[22] Id.
[23] Man (2001) at 5.
[24] Wilcox and Versel (1999)
[25] Not all states restrict the use of TIF to blighted urban areas, however, restrictions included in many enabling statues suggest it is a key policy objective in many states.
[26] Huddleston (1981).
[27] Id. at 380-381.
[28] Huddleston, Jack R. 1984. Tax Increment Financing as a State Development Policy. *Growth and Change*. 15 (Spring), 11-17.
[29] Id. at 14. The analysis found the correlation between population growth and the TIF subsidy rate was +.49. The mean subsidy rate for growing cities was 72.2%, compared to 67.3% for cities with declining population. The study also considered the relationship of the TIF subsidy rate with population size. The study did not find a strong relationship across the state. However, a moderately strong negative correlation

The TIF subsidy rate was also negatively correlated with redistributive state aid, showing communities with a higher median household income and property value base have greater TIF subsidy rates.[30] Huddleston concluded TIF is an effective subsidization method, but may run contrary to state policy objectives designed to encourage development in economically stagnant areas.

Evaluating TIF becomes more difficult when multiple local governments in the same tax jurisdiction use the technique (Huddleston, 1982).[31] A city only receives a net benefit if the tax increment captured from other tax jurisdictions for its TIF project exceeds the subsidy paid to finance TIF projects in other cities. Huddleston demonstrated this by examining nine TIF adopting communities in Milwaukee County, Wisconsin.[32] Only five of the communities received a net benefit from TIF. These cities received high subsidy rates due to their small tax base and relatively low local property tax rate. The other four cities incurred a net loss on their individual projects and could have financed them more effectively with local revenues in the absence of TIF.

In the event tax increment financing provides a significant subsidy to an urban area, there is still no guarantee development will occur in severely blighted communities. Brueckner (2001) created a theoretical model to examine the relationship between property values, public service provision, and TIF.[33] The study acknowledged TIF funded infrastructure improvements can increase property values, but emphasized that the size of the value increase is determined by the level of public goods provided within the district before the TIF is implemented.[34] The TIF investment will not increase property values within the district if public goods are already provided above the socially optimal level. The TIF project may also fail to increase property values in an amount necessary to offset the public investment if public goods are only slightly underprovided prior to the TIF investment. The analysis concluded TIF only increases property values in an amount sufficient to offset the public investment when public goods are moderately to severely underprovided within the proposed TIF district.

Brueckner's model showed TIF was self-financing in areas where public services are significantly underprovided. However, he also distinguished between financial viability and financial need. Infrastructure investment has the largest impact on property values in areas where public goods are provided far below the socially optimal level. In these situations, the growth in the tax base may increase municipal property tax revenues in an amount necessary to cover the public investment. No increase in the municipal property tax rate is required and subsidization from overlying tax jurisdictions is unnecessary.

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was found between population size and subsidy rate for the 17 communities within the Milwaukee metropolitan area.

[30] Id.

[31] Huddleston, Jack R. Distribution of Development Costs under Tax Increment Financing. *Journal of the American Planning Association.* 52 (Spring), 194-198.

[32] Id. at 195.

[33] Brueckner (2000) at 321.

[34] Brueckner utilizes as stationary-state model in which property values only increase in response to public investment. The model also assumes all property in the jurisdiction is residential and no spill-over benefits are created by the TIF outside of the TIF district.

Therefore, tax increment financing is both needed and financially viable only in areas where public goods are moderately underprovided.

Brueckner defined the situation where TIF is both needed and financially viable as TIF's "range of relevance".[35] The range of relevance widens as the proportion of the total property tax rate contributed by overlying tax jurisdictions increases relative to the municipal property tax rate.[36] Municipal revenues are insufficient to cover the cost of infrastructure improvements when the local property tax rate is low. In this situation, subsidization from overlying tax jurisdictions is financially *needed* to fund economic development. Additionally, more projects are financially *viable* because the TIF creates a larger subsidy from other jurisdictions. Even when TIF projects are within the range of relevance there is no guarantee public goods will be provided at a socially optimal level. Public services may exceed or fall short of optimal levels depending on the amount of tax revenue available for public goods.[37]

d. Financial Viability vs. Economic Efficiency

Dye and Sundberg's (1998) work further explored TIF's limitations in severely blighted communities.[38] The authors differentiated between economic efficiency and financial feasibility by considering the effect of opportunity cost in the TIF adoption decision.[39] Financial viability only requires property tax revenues within the TIF district to increase in an amount sufficient to cover the cost of the public investment. However, the financial viability calculation does not consider opportunity cost caused by property value appreciation or depreciation that would have occurred in the absence of a TIF project. When property values would have increased in the TIF district regardless of the public investment, a TIF project may be financial viable but not efficiency enhancing. Overlying tax jurisdictions lose out on revenues they would have received if the TIF was not created. The amount of the opportunity cost is determined by the expected property appreciation rate in the blighted area and the property tax rate applied by overlying jurisdictions. Alternatively, TIF may be efficiency enhancing but not financial viable when the project is designed to limit depreciation in property values caused by urban decay. These projects provide an economic benefit, but do not increase property tax revenues needed to offset the cost of the public investment.

The authors' theoretical model addressed these concerns by estimating the net present value of municipal revenues that would occur without TIF and those that would occur with TIF. The calculation was completed for all tax jurisdictions affected by a TIF project. Expected property tax revenues without TIF were calculated by estimating different property value growth rates for properties located inside and outside of the TIF district. The expected revenue stream was then discounted by an appropriate rate. A TIF

[35] Id. at 338.
[36] Id. at 339.
[37] Id. at 338.
[38] Dye, Richard F. and Jeffrey O. Sundberg. 1998. A Model of Tax Increment Financing Adoption Incentives. *Growth and Change*. 29, 90-110.
[39] Id. at 95.

project was anticipated to result in both a one-time increase in property values caused by the infrastructure improvements, as well as an increase in the annual rate of property appreciation within the district. The model also included a term to reflect fiscal impacts caused by the TIF that are not related to property tax revenues. After inserting a range of estimated pre and post-TIF growth rates into the model, the simulation confirmed TIF projects can be financial feasible without improving efficiency and efficiency enhancing without being financially feasible.[40]

Dye and Sundberg's model also allowed consideration of a number of additional factors influencing the equitability of a TIF project. Development within a municipal TIF district may increase the service demands placed on county government and school districts. TIF can also be used to relocate commercial activity from one portion of a tax jurisdiction to another. Including these factors in the net present value calculation is essential to evaluate the full impact of TIF on each of the tax jurisdictions involved in the project.

e. Property Value Growth and the Misuse of TIF

An overlying concept runs throughout all of the tax increment financing literature previously discussed. Property tax revenues within the TIF district must increase in an amount sufficient to offset the public investment and all related costs. Without property appreciation, TIF does not generate property tax revenues necessary to offset the economic development subsidy and a municipality may be forced to increase property taxes or default on TIF bonds. An understanding of the tax increment financing structure makes this conclusion relatively straightforward. However, a subsidization method based on property appreciation presents an opportunity for misuse. Municipalities already experiencing property appreciation may inappropriately use the technique to capture property tax revenues from overlying tax jurisdictions. These tax revenues would have existed regardless of the TIF project. The following section addresses this concern.

C. Empirical Research

Empirical studies evaluating tax increment financing primarily focus on three issues. First, characteristics of TIF-adopting communities are identified to consider whether growing municipalities are misusing the technique to capture tax revenues from overlying tax jurisdictions. Second, the effect on property appreciation is examined to evaluate TIF's ability to stimulate growth. Third, cost-benefit analyses are completed to determine if increased property tax revenues are sufficient to recover the TIF investment. These studies utilize municipal, neighborhood, and parcel level data to fully explore TIF's economic impact.

[40] Id. at 98.

1. Adoption of Tax Increment Financing

Anderson (1990) used a structural probit model to examine the relationship between TIF adoption, property tax rates, state school funding, and property appreciation.[41] The analysis included 255 cities throughout the state of Michigan.[42] A statistically significant relationship was not found between TIF adoption and school aid or the property tax variables.[43] However, the study found cities with growing populations are more likely to adopt TIF programs.[44] This may suggest TIF projects are used to accommodate economic expansion, rather than stimulate economic development. A positive and statistically significant relationship was also found between TIF adoption and property value growth. However, the results did not determine whether TIF stimulates growth or TIF is adopted to capture property appreciation already anticipated.

Man (1999) also used a structural probit model to evaluate TIF adoption at the municipal level in the state of Indiana.[45] The study included a sample of 150 cities, including 28 TIF districts. Variables were included in the model to consider the influence of fiscal pressure, economic conditions, and jurisdictional characteristics on TIF adoption. The study found cities with increasing property taxes, decreasing levels of state aid, low per capita incomes, large populations, and high concentrations of service industries were more likely to adopt TIF programs.[46] Man also found the existence of a TIF district in a neighboring city significantly increased the probability of TIF adoption.[47] Unlike Anderson's work, the study did not find a statistically significant relationship between TIF adoption and population growth.[48] Man concluded TIF programs in Indiana are not adopted by growing communities to inappropriately capture revenues from overlying tax jurisdictions.[49]

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[41] Anderson, John E. 1990. Tax Increment Financing: Municipal Adoption and Growth. *National Tax Journal*. 43, 155-168. A structural probit model is used to address the potential existence of a simultaneous relationship between the adoption decision and TIF's effect on property values within the municipality.
[42] Of the 255 cities examined in Michigan, 63 adopted TIF projects.
[43] Id. at 161. Huddleston (1981) suggests TIF may undermine policy objectives if higher relative subsidy rates are provided to suburbs rather than cities. Anderson supports contrary results by suggesting TIF provides an attractive subsidy to a municipality regardless of the relative subsidy rate
[44] Id. at 160.
[45] Man, Joyce Y. 1999. Fiscal Pressure, Tax Competition and the Adoption of Tax Increment Financing. *Urban Studies*. 36:7, 1151-1167. In a subsequent study, Man uses the data set to examine the impact of alternative economic development tools. She finds tax abatements are a complementary economic development tool, while TIF acts as a substitute for rehabilitation programs. The study also found adoption of a TIF district by a neighboring city has a significant positive relationship with the TIF adoption decision.
[46] Id. at 537. Federal aid was also included in the model, but a statistically significant relationship with TIF adoption did not exist. The authors suggest a portion of the federal aid variable may have been captured by the state aid variable if federal aid was passed through the state.
[47] Man (1999) at 1158-1160.
[48] Man and Rosentraub (1998) at 538. Reliance on property taxes and the size of the property tax rate were statistically insignificant. The authors also found blight factors (poverty, unemployment, vacancy, and percentage of renter occupied housing) insignificant, but were not surprised by the results because a finding of blight is not required by Indiana's TIF enabling legislation.
[49] Man (1999) at 1165.

Reingold (1998) and Gibson (2003) examined TIF adoption at the census tract level within the city of Chicago. Reingold noted these studies are important because the characteristics of a geographically defined TIF district may vary greatly from those of the municipality as a whole.[50] Using municipalities as the unit of analysis may fail to recognize the actual characteristics of communities adopting TIF. Reingold compared average socioeconomic characteristics between TIF-adopting and non-adopting census tracts.[51] The results suggested both sets of communities generally had similar socioeconomic compositions.[52] However, TIF adopting communities had significantly higher median home values and a significantly lower percentage of owner-occupied housing.[53] Reingold concluded TIF is potentially being used to subsidize redevelopment of "pockets of poverty" within middle to upper income communities. The standard deviation in poverty rates among TIF adopting communities also suggested Chicago is using TIF to assist communities in early stages of decay, as well as more distressed areas.[54]

Gibson (2003) used Weibull hazard models to analyze the relationship between neighborhood characteristics and the timing of TIF adoption.[55] Analyzing the location of TIF projects provided further insight as to whether local governments use TIF projects to assist economically distressed areas or inappropriately apply the technique to capture tax revenues from other entities. Gibson's work added to the existing literature by considering the impact of local political influence on TIF location.

The study concluded TIF is primarily used in economically distressed neighborhoods throughout Chicago. Gibson found the probability of TIF adoption was significantly higher in neighborhoods with higher residential vacancy rates, lower levels of owner occupied housing, and slow property appreciation. Neighborhoods with low per capital income levels, high poverty rates, and slow growth in the retail and manufacturing sectors also had a higher probability of TIF adoption.[56] The study did not find the misuse of political influence to attract TIF projects. Alternatively, a significant negative

[50] Reingold, David A. 2001. Are TIFs Being Misused to Alter Patterns of Residential Segregation? The Case of Addison and Chicago, Illinois. In L. Johnson and J. Man (Eds.), *Tax Increment Financing and Economic Development: Uses, Structures, and Impact*. Albany, NY: State University of New York Press, 223-241.

[51] Id. at 230. Summary statistics for census tracts with and without TIF are averaged to complete the comparison. Socioeconomic indicators included changes in racial composition, changes in population, education, income, median home values, and percentage of owner occupied housing.

[52] Reingold specifically addresses whether TIF is used in Chicago to target areas based on racial composition and finds little evidence of racially motivation.

[53] Id. at 232. The average median home price in TIF adopting communities was 145,001, compared to $93,713 in non-TIF communities. The average percentage of owner-occupied housing in TIF communities was 18.6%, compared to 33.5% in non-TIF communities.

[54] Id. at 234. The study also compares "Developer Initiated" TIF projects and "Community Initiated" TIF projects, finding developers are more likely to target slightly more affluent communities and the city is more likely to target areas with stable Hispanic populations.

[55] Gibson, Diane. 2003. Neighborhood Characteristics and the Targeting of Tax Increment Financing in Chicago. *Journal of Urban Economics*. 54, 309-327.

[56] Id. at 324.

relationship was found between the probability of TIF adoption and the tenure of the district's Alderman.[57]

Gibson pointed out a number of factors suggesting Chicago implemented TIF in "moderately disadvantaged areas" with potential for growth, rather than extremely distressed areas. The hazard of inclusion decreased with per capita income, but increased with percentage change in income. The hazard of inclusion was also significantly lower in census tracts with median housing values in the lowest quartile.[58] A finding of TIF use in moderately disadvantaged areas was consistent with previous theoretical and empirical studies conducted at the municipal level.[59]

2. Property Value Appreciation

Since TIF projects can potentially be adopted to encourage property value growth or capture anticipated growth, studies estimating the impact of TIF on property appreciation must control for selection bias. Man and Rosentraub (1998) used a two-stage probit estimation procedure to examine the impact of TIF adoption on owner-occupied housing values.[60] After controlling for selection bias and a variety of explanatory variables influencing housing prices, the study found adoption of a TIF district had a positive and statistically significant impact on housing values.[61] The model estimated TIF adoption increased the median price of housing by 11.4% relative to municipalities without a TIF district.[62] The authors concluded TIF programs stimulate property value growth and provide considerable "spill-over" benefits in terms of property appreciation outside of the TIF district.

Dye and Merriman (2000) used a similar technique to evaluate the impact of TIF adoption on equalized assessed property value growth in 235 municipalities in Illinois.[63] A probit estimation procedure and independent variables influencing TIF adoption were first used to estimate the probability a municipality will implement a TIF project.[64] Variables representing the pre-adoption property value growth rate, the municipality's fiscal structure, municipal characteristics, and location were used to estimate the probability of TIF adoption.[65] The second stage of the analysis estimated the impact of

[57] Id. at 325. Gibson suggests Alderman pursue alternative economic development strategies producing greater perceived economic benefits.
[58] Id. at 325.
[59] See Brueckner (2001), Dye and Sundberg (1998), Reingold (2001).
[60] Man and Rosentraub (1998). The study looks at the difference between inflation adjusted housing values before and after the creation of a TIF district. A data set similar to the one used in Man (1999) was used to compete the study.
[61] Id. at 539. Community, housing, economic, and fiscal characteristics were included in the model to control for the various factors influencing housing values.
[62] Id. at 541. The price increase occurred after a 2 year lag period.
[63] Dye, Richard F. and David F. Merriman. 2000. The Effects of Tax Increment Financing on Economic Development. *Journal of Urban Economics*. 47, 306-328.
[64] Id. at 313.
[65] Id. at 317. Pre-adoption growth rate was found to have an insignificant effect on the probability of adoption. Of the variables selected to represent fiscal structure, only the municipal property tax rate had a significant positive relationship with TIF adoption.[65] Municipalities with large populations and large

TIF on property value growth rates after adoption. Post-TIF property value growth rates inside and outside the TIF district were regressed on control variables representing community type, fiscal structure, location, size of the TIF district, and years since adoption.[66] A selectivity correlation controlling for self-selection bias was also included, but found statistically insignificant.[67] A significant negative relationship was found between TIF adoption and equalized assessed property value growth within the TIF district and outside the TIF district.[68] Annual property value growth rates within the TIF district grew .79% less than growth rates in non-adopting municipalities. Annual growth rates outside the TIF district were 1.31% less than non-adopting municipalities. Dye and Merriman concluded government subsidies inefficiently reallocate real estate development to less productive locations.[69]

Bryne (2002) used a database of assessed property values in the Chicago metropolitan area and 1990 census data to address two different aspects of TIF.[70] First, the mean demographic characteristics of TIF districts in the Chicago metropolitan area were compared to the characteristics of the municipality in which the TIF is located. Bryne found annualized property value growth in TIF districts exceeded growth in the municipality as a whole by 29.1% in the period between 1990 and 1993. Summary statistics also showed TIF was predominately used in blighted areas with higher unemployment, poverty, and vacancy rates. The comparison suggests TIF is generally used in Chicago to address urban blight. However, approximately 25% of the TIF districts were located in areas with higher median income levels than the municipality as a whole. The findings provide evidence of possible misuse of TIF in economically stable areas.[71]

The second phase of Bryne's study constructed a regression model to determine the influence of various demographic characteristics on property value growth within a TIF district. The dependent variable was defined as the difference between municipal equalized assessed property value growth in the municipality and value growth within the TIF district.[72] The results show the greatest property value increase in commercial and

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percentages of non-residential property were significantly more likely to adopt TIF, while per capita income and poverty rate were insignificant. Finally, dummy variables for two rural counties had a significant negative impact on TIF adoption.

[66] Id. at 320. This regression did not include equalizing school aid and municipal/non-municipal tax rates because there was no theoretical basis. The aggregate property tax rate was anticipated to have a negative impact on property value growth rates.

[67] Id. at 323. Size of the TIF is calculated as share of total EAV within the TIF district.

[68] Id. The magnitude of the negative effect on property values within the TIF district decreased as the size of the TIF district increased.

[69] Id. at 324.

[70] Byrne, Paul F. 2002. Determinants of Property Value Growth for Tax Increment Financing Districts. Working Paper #102. Institute of Government and Public Affairs. University of Illinois at Champaign-Urbana. The sample for the study included 89 TIF districts.

[71] Id. at 5.

[72] Id. at 9. The difference between TIF EAV growth and municipal EAV growth was used to control for differences between economic conditions in the TIF district and the municipality as a whole. Independent variables including population density, vacancy rate, median age of structures and percent white also used the difference between the TIF district and the entire municipality.

industrial TIF districts, which experienced property value growth nearly 20% higher than the area outside the TIF district.[73] Property value growth in mixed-use TIF districts and CBD TIF districts exceeded the municipal growth rate by 12.8% and 1.7% respectively.[74] The regression results also showed recently enacted TIF districts with a relatively higher percentage of white residents, lower population density, and a larger geographic area experienced greater property value growth. The study concluded TIF's impact on property value growth was sustainable over time.[75]

Weber et al. (2003) used parcel level data to consider TIF's impact on industrial property values within the city of Chicago.[76] Appreciation rates within mixed-use TIF districts, industrial TIF districts, and non-TIF districts were examined. The data set included 1708 improved properties and 154 vacant parcels. A multinomial logit model was first used to create a self-selection correction variable.[77] The selectivity correction variable and a number of control variables were then included in an OLS regression to estimate the impact of TIF adoption on industrial parcel values.[78] Based on a series of specifications, the authors concluded location within an industrial TIF district does not increase the value of industrial parcels in Chicago. Some evidence existed that vacant industrial land included in an industrial TIF district may even decrease in value compared to industrial parcels not located within a TIF district. Alternatively, the study found location within a mixed-use TIF district did not decrease industrial property values and may actually increase values slightly.[79] The authors hypothesized that TIF does not decrease industrial land values within a mixed-use TIF district because the property owner has the ability to increase the property value by converting to residential or commercial use.[80]

3. The Financial Feasibility of TIF Projects

It remains unclear whether tax increment financing increases property values. Even if property values do not increase, TIF may increase economic efficiency by stopping property depreciation within a blighted area. However, a project is financially feasible only if the incremental property tax revenues are sufficient to offset the TIF investment. This may require significant property appreciation in the TIF district. Empirical studies have analyzed whether increased tax revenues are sufficient to cover the cost of infrastructure improvements.

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[73] Id. at 12.
[74] Id.
[75] Id. at 13.
[76] Weber, Rachel, Saurav Dev Bhatta and David Merriman. 2003. Does Tax Increment Financing Raise Urban Industrial Property Values? *Urban Studies*. 40:10, 2001-2021.
[77] Id. at 2006. A multinomial logit model is used because self selection must be addressed for both mixed-use TIF districts and industrial TIF districts. Independent variables used to predict preference for TIF adoption include site, neighborhood, and location variables including location of the property within a defined industrial corridor.
[78] Id. at 2009. The dependent variable is the natural log of the parcel's sale price. Control variables include TIF related variables (location in/out of a TIF district, industrial TIF, mixed-use TIF, months since TIF adoption) site variables (log of land area, building area and the year built), location variables (distance from highways, CBD, and other TIF projects), and neighborhood characteristics.
[79] Id. at 2017.
[80] Id. at 2018.

Huddleston (1982) completed a discounted cost-revenue analysis to evaluate the impact of TIF on both sponsoring governments and overlying tax jurisdictions.[81] Public revenues and costs were estimated for 16 TIF projects in Wisconsin.[82] Property value growth within the TIF districts was estimated to range from 1-5% above the estimated value growth without TIF investment.[83] Discount rates of 6% and 12% were used to represent favorable and unfavorable borrowing rates. Under an assumption of strong value growth and favorable borrowing conditions, Huddleston found only 2 of the 16 projects generated a positive net present value for the sponsoring government before the TIF district was scheduled to terminate. Overall, 14 of the projects reached breakeven within 30 years, with an average breakeven period of 13.9 years. Only 11 of the contributing governments broke even within 30 years, with an average breakeven period of 23 years.[84] Huddleston concluded TIF must be viewed as a long-run public investment.

Stinson (1992) used a similar cost-benefit analysis to determine the financial feasibility of 11 TIF projects located in rural communities throughout southern Minnesota.[85] Property value and tax rate information was obtained from each county assessor's office and information on the initial TIF bond issue was obtained from the county auditors.[86] TIF-induced property appreciation was estimated to range from 0% to 5%. Based on an assumption of 5% annual property value growth, only 7 of the 11 projects generated incremental revenues sufficient to cover the TIF bond debt service.[87] The poorest performing project required a 10-fold increase in incremental tax revenues to retire the TIF bond on time. Stinson concluded many TIF projects in rural Minnesota may require transfers from the municipality's general fund to cover debt service on TIF bonds.[88]

Lawrence and Stephenson (1995) conducted a financial analysis of a TIF project in downtown Des Moines, IA.[89] Property values were observed from the creation of the TIF district in 1973 through 1993. The authors controlled for property value growth that would have occurred without public investment by estimating a natural growth rate for the area. The rate was derived by observing property value growth in a control area

[81] Huddleston, Jack R. Local Financial Dimensions of Tax Increment Financing: A Cost Revenue Analysis. *Public Budgeting and Finance*. 2 (Spring), 40-49. The municipality implementing a TIF project is defined as the "sponsoring" community.
[82] Id. at 45. Public information was used to obtain development expenditures and related costs. In the event information was unavailable, Huddleston outlines assumptions made to estimate revenues and costs.
[83] Id. at 46. Property value growth created by the TIF is estimated because information was unavailable. The study also assumes the TIF project does not increase public service expenditures for the sponsoring or contributing governments.
[84] Id. at 46-48. Under unfavorable conditions (1% induced growth and 12% discount rate) only 10 sponsoring governments and 3 contributing governments generated a positive NPV within 30 years.
[85] Stinson (1992) at 242. The study focuses on non-metro communities with population under 10,000.
[86] Id. at 244. The size of the initial TIF bond issue, terms of the bonds, and interest rate were available from the auditors office.
[87] Only 5 of the 11 projects generated revenues sufficient to cover the debt service at 0% and 2% annual property value growth.
[88] Id. at 245.
[89] Lawrence, David B. and Susan C. Stephenson. 1995. The Economics and Politics of Tax Increment Financing. *Growth and Change*. 26 (Winter), 105-137.

comprised of commercial and industrial parcels outside the boundary of the TIF district. The net benefit of the TIF project was calculated by subtracting natural property value growth and the public expenditure within the TIF district from the total tax increment.[90] The project did not generate a positive subsidy between 1973 and 1991, but did create a subsidy in 1991 and 1992 totaling over $90 million.[91] Lawrence and Stephenson estimated the TIF district would continue to generate a significant positive subsidy between 1994 and 1998.[92]

The existing body of empirical research offers differing opinions on the benefits of tax increment financing. Several studies find communities are appropriately using the technique to encourage development in deteriorating areas. Others highlight the potential for misuse and focus on TIF's failure to significantly increase property tax revenues. While these results initially appear contradictory, the literature provides a number of reasons why TIF should impact communities differently. The structure of a state's enabling legislation may influence the potential for misuse and existing economic conditions within an area may dictate TIF's financial viability. Further, it is important to note property tax revenues are not the only consideration when evaluating TIF. Empirical studies have found TIF can have a positive impact on other economic development indicators, such as retail and service industry growth.[93] Consideration of such factors may provide a greater understanding of the benefits and burdens of tax increment financing.

D. Best Practices

Although tax increment financing potentially offers a number of benefits, the existing literature suggests municipalities may also face significant economic challenges. The cost of TIF may exceed other public finance methods. The availability of TIF may create disputes among local government entities. The technique may not be feasible in severely distressed urban areas, and on the other hand, may be misused by growing communities to capture property tax revenues. Most importantly, TIF may not increase property tax revenues in an amount necessary to offset the public investment. Many of these concerns are legitimate and supported by empirical evidence. Fortunately, a number of best practices have been identified over six decades of TIF use in the United States. These risk mitigation strategies provide municipalities with guidance in the use of tax increment financing.

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[90] Id. at 127-128.

[91] Id. Lawrence and Stephenson explain the TIF district did not generate a positive subsidy in 1993 because a large portion of the revenues were used to retire debt.

[92] Id. at 129. The estimated aggregate subsidy between 1994 and 1998 exceeds $370 million.

[93] Wassmer, R.W. 1994. Can Local Incentives Alter a Metropolitan City's Economic Development? *Urban Studies*. 31:8, 1251-1278. Wassmer examines a number of economic development incentives and concludes many are ineffective in generating growth. However, the regression analysis found TIF had a positive impact on the retail and service industries in Detroit.

1. Limit Financing Costs

Managing debt service costs is necessary to enhance the attractiveness of tax increment financing. Some municipalities limit costs by guaranteeing TIF bonds with the full faith and credit of the local government. Others guarantee property value assessments within the TIF district in an amount sufficient to service bond debt. Moderate to conservative debt service coverage ratios may also be appropriate.[94] However, financing costs can be reduced most effectively by ensuring TIF projects are well planned and financially attractive to the municipal bond market. An extremely conservative approach is unlikely to be necessary due to the success of many TIF projects and an established market for TIF bonds.[95] Additionally, an assumption that TIF bonds are implicitly backed by the full faith and credit of a municipality may decrease the risk premium required by the bond market.

2. Involve Overlying Tax Jurisdictions

County governments, school districts, and other tax jurisdictions can potentially benefit from TIF projects, but they may also lose. Property tax revenues may be inappropriately diverted away from these entities. Additionally, school districts and county governments may be left to provide public services to the growing population within a TIF district without a corresponding increase in tax revenues. Exposure to these risks has encouraged overlying tax jurisdictions to become increasingly involved in early phases of the planning process. Allowing these entities to actively participate and negotiate may limit a local government's exposure to future litigation.[96] Capping the amount of the tax increment and allowing tax base adjustments over time may also prevent windfall gains to the TIF sponsoring government.[97]

Cooperation among tax jurisdictions is also useful to prevent economic development bidding wars between communities. The use of TIF and other subsidies is likely to continue to the extent communities can successfully attract industry from other regions. However, competition among communities within the same overlying tax jurisdiction is generally considered a zero sum game with no net benefit.[98] Coordinated economic development efforts with surrounding communities may reduce tensions and limit unnecessary subsidies.

3. Avoid Inappropriate Use

TIF projects are subject to the greatest amount of criticism when they are implemented in areas that do not appear economically distressed. Such projects may be perceived by overlying tax jurisdictions as exploitative and viewed by local residents as corporate

[94] Johnson (2001) at 85.
[95] Id.
[96] Sullivan et al. (2002) at 7.
[97] Johnson (2001) at 85. Brueckner's (2001) model suggests limiting the tax increment may also prevent suboptimal infrastructure investment. TIF sponsoring governments have an incentive to continue investment in the TIF district above a socially optimal level if proceeds are available.
[98] Man (2001) at 5. Dye and Merriman (2000) at 308.

welfare. Enabling legislation in most states limits the use of TIF to blighted areas, but local governments have apparently stretched the definition of blight. Best practice studies offer a number of suggestions to limit inappropriate use.

Strict application of the "but for" standard is the most often sited means of preventing abuse. TIF should only be used in areas where development would not occur but for public subsidization. Sullivan et al. (2002) suggested avoiding areas with above average property appreciation, large tracts of undeveloped land, locations on the urban fringe, and tracts already owned by industry.[99] These types of locations have a high probability of development without public assistance. Wilcox and Versel (1999) also advised avoiding excessive public investment by requiring high private/public investment ratios in the range of 12:1.[100]

4. Understand the Limitations of TIF

TIF may be an inappropriate economic development tool in severely distressed areas and rural locations. In urban areas experiencing economic decline and property depreciation, infrastructure investment may provide an economically efficient means of stabilizing property values. However, the subsidy created by TIF requires property appreciation above existing levels.[101] Without a positive tax increment, no funds are available to offset the public investment. Redevelopment projects in these distressed urban areas may also require relocation of low income residents and assemblage of multiple real estate parcels. The financial viability of a TIF project is sensitive to these upfront costs, further limiting its usefulness in some urban areas.[102] Existing literature supports TIF use in moderately disadvantaged neighborhoods where modest public investment can generate a substantial return.

A similar problem exists in communities located outside metropolitan areas. The property appreciation stimulated by TIF may be considerably lower than could be achieved by a comparable investment in an urban location. Stinson (1992) suggested a conservative estimate of property appreciation in isolated rural communities. He also advised limiting the initial TIF investment below the anticipated NPV of the future tax increments.

5. Conform to General Development Guidelines

The best practices literature notes tax increment financing projects should be evaluated using many of the same standards applied to other forms of public-private partnerships. Development should conform to the municipality's master plan and enhance the public good.[103] Projects lacking extensive public support should be considered with caution, especially those failing to pass a previous bond referendum.[104] Proposed projects should

[99] Sullivan (2002) at 6-7.
[100] Wilcox and Versel (1999) at 24.
[101] Dye and Sundberg (1998) at 95.
[102] Sullivan (2002) at 1.
[103] Sullivan (2002) at 16.
[104] Id.

be carefully underwritten with attention paid to the existing conditions within the real estate and capital markets. Each of these steps helps ensure tax increment financing is used in a beneficial manner.

E. Conclusion

The use of tax increment financing continues to grow in the United States as communities seek alternative methods to finance economic development. The popularity of TIF is to some degree related to the perception it provides local governments with a cost-free subsidy for economic development. However, existing literature shows TIF is a complex finance technique with potentially significant economic consequences for both sponsoring government and overlying tax jurisdictions. Local governments must understand the economic implications when considering TIF projects.

TIF may provide a valuable economic development tool because it allows local governments to engage in economic development projects they could not undertake without assistance from other tax jurisdictions benefiting from the project. The TIF structure compels these government entities to participate in an amount proportionate to their anticipated future gain. The ability to stimulate economic growth without increasing local property tax rates has made TIF a political viable alternative and a number of successful projects continue to be developed.

The potential benefits of TIF are widely noted, but existing literature suggests the technique should be used with some caution. Empirical evidence shows TIF may be misused in areas already experiencing economic growth. Other studies have found TIF may fail to increase property values in an amount necessary to offset the public investment made in the TIF district. TIF may also create tension between tax jurisdictions competing for economic development projects. Adhering to a number of best practices may address the majority of these concerns.

Local governments considering the use of TIF should engage in extensive planning to evaluate the projects feasibility under existing market conditions. Overlying tax jurisdictions should also be consulted early in the project planning phase to avoid future arguments over tax revenues. Clear guidelines should be created to ensure TIF projects conform to the community's comprehensive plan and are not located in economically stable areas. Additionally, communities considering TIF projects must understand the limitations of this economic development tool. Tax increment financing may prove to be a valuable economic tool for communities following these guidelines.

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III. Regional Stakeholder Interviews

In the process of developing a guide to Tax Increment Financing (TIF) and designing hypothetical TIF districts for economic modeling, informational interviews were conducted to gather information from professionals who are or were likely to be directly involved with TIF. Interview questions were distributed to various stakeholders, including government financing specialists, government and private economic development specialists, real estate attorneys and real estate development professionals in the greater Charlotte region. The questions were developed primarily for the governmental professionals listed above and were adapted to fit the perspectives of the other professionals. We assumed that some, and perhaps all, of these stakeholders were active supporters of the constitutional amendment authorizing TIF and that many would be evaluating potential TIF projects.

The questions were intended to facilitate discussion on key points to be covered with the experts in interviews, rather than as a survey instrument to be applied exactly. The questions were presented in an order to provide for a logical flow to the conversation rather than as a sequence to be followed strictly. The actual questions are listed below to illustrate the focus of the interviews.

- What do you see as the pros and cons of TIF in general? As enacted in NC?
    - How does TIF compare to other methods of financing public investments that are intended to spur private development? (if not specifically mentioned, ask about other bond revenue sources and 'synthetic TIF')
    - Are there kinds of projects or characteristics of projects that you think make TIF a particularly good fit?
    - What about those that might rule out using TIF? (what about small town vs. big city, residential vs. commercial vs. industrial, size of projects, etc.)
- What plans, if any, does your organization/your clients have for using TIF?
    - Have any developers/local governments approached you to discuss potential TIF projects?
    - Have you approached any developers/local governments about potential TIF projects?
    - Has your local jurisdiction created or begun exploring procedures for creating TIF projects/districts?
    - When you (local government) think about initiating a TIF district, how will you go about that (i.e., talk privately with 1 or a few developers to gauge market interest and type of public investment, or request proposals in a public process?)

- Are you aware of any other places in NC that are actively pursuing or thinking about using TIF?
- Are there other people in the region that you think would be particularly helpful for us to talk with?

The information gathered from the stakeholders was then compiled into a list of significant pros and cons of TIF, as shown below.

Stakeholder Interviews Summary	
Pros	**Cons**
TIF may generate positive spillover effects to surrounding areas.	Manufacture wage test involved when the TIF project has manufacturing component
May cause change policy decisions which will likely shift local development patterns	IPC may be a better financing tool if the time for project financing needed is less than five years
TIF can reach low priority investments such as sidewalks	Industrial relocation incentives conflict with TIF
TIF projects are usually quicker than General Obligation Bonds (GOB).	20% retail limit outside Central Business District (CBD) or enterprise tier one areas is a significant constraint when applying TIF
Redevelopment possibilities are good for TIF projects	Synthetic TIF may be simpler and less cumbersome
TIF bonds are not subject to the 8% of total assessed valuation that applies to GOBs and IPCs	TIF is difficult to implement for small towns because of the low tax rate, 5% land limit, and high costs of bond issuance
	Financial markets have difficulty with TIF debt because of ambiguous future revenues

The feed back from the survey also prompted further suggestions, examples and potential projects involving TIF. Listed below are key suggestions that were thought to be noteworthy.

- TIF is more likely to work in an area where there is a shortage of land, and more room is needed to grow.
- There are certain attributes which make use of TIF more advantageous to larger cities.
- TIF is good for stable communities that are not heavily in debt

- Potential good fits include large mixed-use projects or office parks. These projects tend to gain immediate occupancy and have more predictable revenue sources. (E.g. Monroe airport office/industrial park)
- Potential TIF projects may include transit stations.
- Residential (primarily residential) projects, especially single family housing is not a good fit for TIF, unless high density areas are used.
- TIF is widely used in SC – virtually all cities of any size in SC have used it.

The interviews indicated that TIF is considered to be a valuable tool for use in certain situations and areas. As illustrated by the data presented, including pros, cons, suggestions, examples, and potential projects, TIF may be more advantageous to larger towns and cities, or counties with non-industrial projects, and it may be a better fit for stable, low debt communities. Should a jurisdiction be near its general obligation debt limit, however, TIF may provide a tool for economic development that is otherwise not available. The North Carolina legislation, as written, prescribes a conservative approach to using TIF. Although these laws were intended to prevent many of the problems seen in other states, they also include requirements that may limit TIF use by jurisdictions in North Carolina.

IV. Recent Survey Data on Tax Increment Financing

This section reports on two recent surveys containing information on the use of TIF. The first, conducted by the International City/County Management Association in 2004 and 2005, was a nationwide survey of city and county governments and obtained information on economic development practices. Tax increment financing was the second most commonly used source of revenues for economic development reported by the respondents. Characteristics of users and non- users are compared.

The second survey, conducted in March and April of 2006, was of a small random sample of city and county officials, local economic development specialists, and planners in North Carolina. This survey asked specifically about actual and planned use of TIF. Interest in it appears to be growing in these local governments. A majority reported that TIF is likely to be an effective tool for economic development and fifteen percent reported that TIF was being seriously considered for a project in their jurisdictions.

A. ICMA National Survey

The following reports results from a survey on economic development activities distributed by the International City/County Management Association (ICMA) to a national sample of local governments. Several questions asked about tax increment financing (TIF). This chapter reports on the responses to these items.

The ICMA mailed economic development surveys in the fall of 2004 and spring of 2005 to Chief Administrative Officers in municipalities with populations of 10,000 and over and in counties with populations of 50,000 and over with the council-administrator or council-elected executive form of government (ICMA, Economic Development 2004). Surveys were sent to 3,703 municipalities and counties. Of these, 726 local governments responded for a response rate of 19.6%.

1. Tax Increment Financing Across the Nation.

TIF is a popular tool for local economic development. An extensive literature reports its use in various states. The ICMA survey, however, is one of the few providing recent national data. Reference to TIF as a revenue source to support economic development was included in a question with the results shown in Table 1.

Table 1. Sources of government revenue used to support economic development programs.

Source	Percent of Governments
1. Local revenues/general fund	67.2
2. Tax increment financing districts	21.6
3. State grants-in-aid	19.4
4. Federal grants-in-aid	17.6

5. Hotel/motel taxes	15.3
6. Sales tax	14.0
7. Other	7.8
8. Special assessment districts	7.6
9. General obligation bonds	6.6
10. Revenue bonds	6.6
Number of respondents	726

TIF districts were the second most commonly listed source of government revenue used to support economic development programs.

The response to the item asking about which government revenue sources were used to support economic development programs was used as a filter to separate the local governments using tax increment financing districts from those who did not. Some governments not classified as TIF users by this criterion reported offering tax increment financing as a business incentive. No survey questions inquired as to policies regarding the use of TIF.

Table 2 shows how respondent jurisdictions using TIF and those not using TIF used other sources of government revenue for economic development. The percent using local revenues and/or general fund revenues was highest for both groups with 86 percent of the TIF user's and 62 percent of the non-TIF users reporting this category. Those respondents who use TIF for economic development clearly also use other resources and incentives to a greater extent than do those respondents who do not use TIF.

Table 2. Use of Revenue Sources, TIF and Non-TIF Respondents

Revenue Sources Used for Economic Development						
	TIF Users		**Non TIF Users**		**Total**	
Sources of Government Revenue Used to Fund Economic Development Programs	Number	%	Number	%	Number	%
Tax Increment Financing Districts	157	-	0	-	157	21.6
Local Revenues/General Fund	135	86	353	62	488	67.2
State Grants-in-Aid	54	34	87	15	141	19.4
Federal Grants-in-Aid	47	30	81	14	128	17.6
Hotel/Motel Taxes	40	25	71	12	111	15.3
Revenue Bonds	33	21	15	3	48	6.6
Special Assessment Districts	32	20	23	4	55	7.6
Sales Tax	27	17	75	13	102	14
General Obligation Bonds	22	14	26	5	48	6.6
Other	12	8	44	8	56	7.7
Total	157	100%	569	100%	726	100%

2. Geography, Population and Tax Increment Financing.

TIF use differs greatly by region. The ICMA uses the following five membership regions: Northeast (NE); Southeast (SE); Midwest (MW); Mountain Plains (MP); West Coast (WC). Although TIF was authorized for use in 48 states prior to 2004, it is used much more heavily in the West and Midwest states than in other parts of the country. The North East group of states had the smallest percent of TIF users among respondents than any other region.

Table 3 shows the total number of respondents from each ICMA region and the percent of those respondents who have used TIF for economic development. Thirty-three percent of respondents from the Midwest region reported using TIF revenues to support economic development, the highest percent of any region. The West Coast region had the second highest at 31 percent whereas the Southeast and Northeast had the second lowest and lowest percent at 13 and 8.4 respectively.

Table 3. Percent of Respondents Using TIF By ICMA Region.

ICMA Membership	TIF Users		Non TIF Users		Total	
Region	N	%	N	%	N	%
MW	71	33	145	67	216	100
WC	34	31	75	69	109	100
MP	22	16.5	111	83.5	133	100
SE	21	13	140	87	161	100
NE	9	8.4	98	91.6	107	100
Total	157	21.6	569	78.4	726	100%

Although counties were authorized to use TIF in 23 of the 48 states with TIF in 2004, only five of the 89 counties responding to the ICMA survey indicated that they used TIF revenues to support economic development. This was 3.2 percent of all TIF users.

Council manager municipalities were the most numerous respondents to the survey. Mayor-council and council-manager cities were almost equally likely to use TIF, with approximately 24 percent of cities in each group doing so. This conflicts with other research reporting that TIF is most likely to be used in jurisdictions with council manager governments.

According to some literature, larger jurisdictions are more likely to use TIF than are smaller jurisdictions. The ICMA survey data, however, show that jurisdictions in the small to midsize range are more likely to use TIF. Table 4 shows the number of respondents in each population category and the percent that report using TIF. The two highest are 29 percent of respondents in populations of 25,000-49,999 and 24 percent of respondents in the 50,000-99,999 category using TIF.

Table 4. Number and Percent of Respondents in Each Population Group Using TIF

Population Size	TIF Users		Non TIF Users		Total	
	N	%	N	%	N	%
10,000-24,999	59	18.6	259	81.4	318	100
25,000-49,999	46	28.8	114	71.2	160	100
50,000-99,999	30	24.4	93	75.6	123	100
100,000-249,999	17	19.8	69	80.2	86	100
250,000-499,999	3	14.3	18	85.7	21	100
500,000-1,000,000	2	14.3	12	85.7	14	100
Over 1,000,000	0	0	4	100.	4	100
Total	**157**	**21.60**	**569**	**78.40**	**726**	**100**

3. Measuring the Effectiveness of Economic Incentives

The ICMA survey asked about the type of analysis conducted for business incentives and the measures used to assess their effectiveness. For the respondents who offered business incentives, about equal percentages (60.3 to 61.3 percent) of TIF users and non-users required performance agreements as a condition for receiving a business incentive.

However, TIF users are more likely to conduct a cost benefit analysis prior to providing the incentive (81 to 72 percent) and to report measuring the effectiveness of business incentives (88 to 81 percent). This may indicate that the requirements for issuing TIF bonds impose a stricter set of analyses on the use of TIF than is the case for other incentives. Table 5 shows these and other comparisons.

Table 5. Analysis and Measures of Effectiveness for Business Incentives.

	TIF Users		Non TIF Users		Total	
Performance Agreement Required?	Number	%	Number	%	Number	%
Always	73	60.3	165	61.3	238	61
Sometimes	39	32.2	70	26.	109	28
Never	9	7.5	34	12.6	43	11
Total	121	100%	269	100%	390	100%
Cost/Benefit Analysis Prior to Offering Business Incentives?						
Yes	97	80.8	193	72.3	290	75
No	23	19.2	74	27.7	97	25
Total	120	100%	267	100%	387	100%
Measure the Effectiveness of Business Incentives?						
Yes	106	88.3	220	81.5	326	84
No	14	11.7	50	18.5	64	16
Total	120	100%	270	100%	390	100%

Jurisdictions using TIF and those not using TIF did not differ much in the use of specific effectiveness measures although TIF users were more likely to use each effectiveness measure than were jurisdictions not using TIF. (See Table 6.) The biggest difference was in the percent of local governments measuring new dollars invested in land (35 to 28 percent).

Table 6. Effectiveness Measures Used by Respondents for Business Incentives.

	TIF Users		**Non TIF Users**		**Total**	
Which Measures of Effectiveness Are Used?	Number	Percent	Number	Percent	Number	Percent
Amount of Jobs Created by the New Business	93	59%	201	55%	294	56%
Amount of Money Invested in Construction Materials and Labor	63	40%	142	39%	205	39%
New Dollars Invested in Land	55	35%	102	28%	157	30%
Number of New Businesses Relocating or Expanding in Jurisdiction	49	31%	104	28%	153	29%
Cost/Benefit/Analysis	48	30%	100	27%	148	28%
Company Revenue/Sales	38	24%	65	18%	103	20%
Other	9	6%	26	7%	35	7%
Total	157		366		523	

4. Taxes and TIF Users.

In general, respondents using TIF and those not using TIF differed in the taxes levied, both in type and rate. Those jurisdictions which do not use TIF for economic development rely on traditional taxes to a greater extent than do the jurisdictions using TIF. Although a majority of both groups use real property and sales taxes, a greater percent of non TIF respondents levy these taxes and, on average, at a higher rate. The biggest difference in the use of a tax is for personal property tax with non TIF jurisdictions more likely to use it 59 to 48 percent. TIF users, however, were more likely to use other local taxes than were jurisdictions not using TIF. Table 7 compares taxes and tax rates for the two groups.

Table 7. Taxes and Tax Rates Levied By TIF Users and Non-Users						
	TIF Users		**Non TIF Users**		**Total**	
Taxes Local Government Levies	Number	Percent	Number	Percent	Number	Percent
Real Property Tax						
Yes	111	88.10%	344	92.47%	455	91.4%
No	15	11.90%	28	7.53%	43	8.6%
Total	126	100%	372	100%	498	100%
Tax Rate (Average %)	4.50%		4.80%			
Personal Property Tax						
Yes	49	48.04%	181	59.15%	230	56.4%
No	53	51.96%	125	40.85%	178	43.6%
Total	102	100%	306	100%	408	100%
Tax Rate (Average %)	4.60%		4.30%			
Local Income Tax						
Yes	16	16%	50	19%	66	17.9%
No	85	84%	218	81%	303	82.1%
Total	101	100%	268	100%	369	100%
Tax Rate (Average %)	1.10%		1.80%			
Local Sales Tax						
Yes	63	57%	202	65%	265	62.5%
No	47	43%	111	35%	158	37.4
Total	110	100%	313	100%	423	100%
Tax Rate (Average %)	2.90%		2.96%			
Other Local Tax						
Yes	40	71%	73	59%	113	63%
No	16	29%	51	41%	67	37%
Total	56	100%	124	100%	180	100%
Tax Rate (Average %)	5.20%		4.10%			

5. Economic Characteristics and TIF Users.

The ICMA survey obtained information on several economic measures for the governments surveyed. These included median cost of single family housing, rental costs, unemployment rate, and others. The only statistically significant difference between the two groups on these measures was for per capital personal income and per capita property tax rate. Both of these are lower for the TIF users than for the non-TIF jurisdictions. Table 8 shows this information.

Table 8. TIF Users and Non-Users By Economic Characteristics of Jurisdiction			
	TIF Users	**Non TIF Users**	**Sig.**
Median Cost of Single Family Dwelling	$219,730.84 N = 119	$212,890.03 N = 318	NS
Median Rental Cost of 2 Bedroom Apartment	$842.06 N=116	$847.72 N=296	NS
Number of Hotel/Motel Rooms	1223 N=118	3533.24 N=299	NS
% of Local Government's Annual Revenue from Tourism	6.08% N=96	4.51% N=264	NS
Per Capita Personal Income (Average)	$30,624.79 N=103	$36.351.66 N=269	.007
Per Capita Property Tax Revenue (Average)	$407.99 N=85	$741.01 N=204	.002
Unemployment Rate	5.05% N=118	4.71% N=293	NS

There did not appear to be major differences in the focus of economic development efforts of TIF users and non-users. The most common focus for both groups is manufacturing. The largest differences in the percent of the two groups focusing on an area are in retail and service-27.1 to 29.5-with a higher percent of non-TIF; technology and communications with a higher percent of TIF users (18.1 to 14.9); and in tourism with TIF users more likely to focus in this area (6.9 to 3.7 percent).

6. North Carolina's Neighbors and Tax Increment Financing

An argument for the amendment in 2004 to the North Carolina Constitution allowing TIF was that all of the states bordering North Carolina authorized the use of TIF. As noted in the section reporting on key expert interviews, many South Carolina local governments use TIF. Of the 65 ICMA survey respondents from states directly bordering North Carolina, only six reported using TIF. None of the 20 respondents from Virginia reported using TIF and only one of 21 respondents from Georgia used TIF. Table 9 reports on ICMA survey respondents from states surrounding North Carolina.

Table 9. Number and Percent of TIF Users From Neighboring States.

	TIF Users		Non TIF Users		Total Respondents	
State	**Number**	**%**	**Number**	**%**	**Number**	**%**
Georgia	1	<5	21	95	22	100
South Carolina	2	25	6	75	8	100
Tennessee	3	20	12	80	15	100
Virginia	0	0.00	20	100	20	100
Total	**6**	**9.2**	**59**	**90.8**	**65**	**100**

Although these numbers are too small to provide much confidence in their accuracy when applied to the entire state, they are consistent with anecdotal and interview information. Economic development officials interviewed for this project stated that many jurisdictions in South Carolina use TIF. Two of the eight respondents from South Carolina use TIF (25 percent), a higher rate than from any other state bordering North Carolina.

The survey data appear to show that local governments using tax increment financing are more involved in economic development efforts than are those who do not use TIF. Those governments using TIF also are more likely to use a range of other tools. Respondents listed TIF districts as the second most commonly used source of funds for economic development next to general funds. General obligation and revenue bonds were not used often to support economic development efforts. North Carolina local governments also fund economic development from general fund revenues. TIF projects may prove to be an alternative to these resources rather than an alternative to general obligation bonds.

States in the Southeast region of the country were less likely to be TIF users than those in any other region except for the Northeast. However, among North Carolina's neighbors, local governments in South Carolina may be most likely to use TIF. A larger percent of respondent local governments in the Midwest are TIF users than in any other region. Other characteristics of likely TIF users are cities in the population range of 25,000 to 100,000 with lower per capita incomes and lower per capita property tax revenues. TIF users are less likely to use a range of local taxes than are non TIF jurisdictions. Since North Carolina has many local governments within this population range, they cannot use local income taxes and personal property taxes are limited, the interest in TIF in North Carolina may follow this national course.

B. North Carolina Tax Increment Financing Survey

Printed surveys were sent in March of 2006 to a sample of 295 city and county finance officers, economic development specialists, and planners in North Carolina with stamped,

self addressed return envelopes. Individuals in Economic Development Commissions and Councils of Governments were included. A copy of the survey was also sent electronically to a separately identified sample of planners. A total of 107 surveys were returned. Since it was possible for more than one individual in a jurisdiction to return a questionnaire, an attempt was made to identify duplicates from any jurisdiction.

The following summarizes the survey responses. A copy of the survey instrument with all items is included as an Appendix.

- 55.1 percent of respondents (59) reported that TIF is likely to be an effective economic development tool for local governments in North Carolina. (Item 5)

- The two most important benefits of TIF to North Carolina local governments as identified by respondents were: (1) provide another incentive tool to attract new business (49.5 percent) and (2) assist in financing the redevelopment of blighted or abandoned areas (45.8 percent). (Items 6A and 6B – percents combined).

- 28.0 percent of respondents (30) identified the public perception of TIF and the complicated and time consuming process of using TIF as the biggest concerns regarding its use. (Item 7).

- 71 percent of respondents (76) reported that someone in their organization had taken steps to learn more about TIF. These actions included workshops; meetings with other local government officials, Local Government Commission staff and with attorneys specializing in TIF; and researching the legislation. (Items 8 and 9)

- Two local governments reported hiring staff to work on TIF projects and seven reported having established guidelines for using TIF. (Items 10 and 11).

- 31.8 percent of respondents (34) reported that installing or improving infrastructure to encourage development of an area to be the most effective use of TIF in North Carolina. 28 percent (30) reported revitalizing a blighted area to be the most effective use. (Item 12)

- 15 percent (16) respondents reported that TIF was being seriously considered for a current or proposed project in their jurisdiction. (Item 16 and Table 10).

- Table 11 lists the projects described by those respondents seriously considering TIF. (Item 16 a)

- 10.3 percent (11) of the respondents reported that they either had begun to create a TIF district, had approval for a TIF district, or had a project and intended to use TIF as soon as practical. 26.2 percent (34) reported that they were not likely to use TIF in the foreseeable future. (Item 13 and Table 12.)

- Table 13 lists the types of projects respondents thought would be good options for North Carolina local governments to use TIF.

- 26.2 percent (28) of the respondents who were not currently considering projects for TIF reported that they were either very likely or likely to do so within the next two years. (Item 17)

- Respondents were asked to rate several factors on how serious the factors were as a barrier to using TIF in their jurisdictions. (Item 18A – 18J). The four factors rated the highest as serious barriers are:

  1. The complicated and lengthy qualification process required for TIF. 37.4%
  2. Lack of a large scale project that can utilize TIF. 30.8%
  3. Lack of knowledge regarding TIF. 29.9%
  4. Public perception. 29%

- The most frequently used source of funds for economic development or redevelopment projects was local revenues from the general fund with 36.4 percent of the respondents reporting that they used this source frequently.

- Respondents reported that local revenues from the general fund would be the source most likely to be used less if TIF is used. In other words, the use of TIF financing is likely to replace general fund revenues for economic development and redevelopment projects.

Counties are allowed to use TIF under the North Carolina legislation. Tables 10 and 12 show the distribution of responses regarding potential TIF use by type of jurisdiction. Two responding counties and three cities have plans to use TIF. An additional three cities, but no counties, have begun the process of creating TIF districts.

Table 10. Likely TIF Use By Type of Jurisdiction

	Jurisdiction Type											
Is TIF being seriously considered in your area?	County Government		City Government		Council of Government		Other				Total	
	Freq	%	Freq	%	Freq	%	Freq	%			Freq	%
Yes	3	9.1	9	20.5	0	0	4	21.1			16	15
No	29	87.9	35	79.5	7	70	9	47.4			80	75
Don't know	0	0	0	0	1	10	2	10.5			3	3
Not answered or answer not applicable	1	3	0	0	2	20	4	21.1			7	7
Total	**33**	**100 %**	**44**	**100 %**	**10**	**100 %**	**19**	**100 %**			**106**	**100%**

Table 11. **TIF Projects Being Considered By Survey Respondents**

A joint four county industrial park project
Carolina Crossroads Music and Entertainment District (This has been approved.)
Development of super or mega-site for economic development purposes
Downtown development/revitalization
Infrastructure for large commercial project
Parking structure component of Brownfield redevelopment project.
Increment on $3,000,000 project too small to generate significant public investment
Mixed residential, commercial infill – with historic preservation – in a blighted neighborhood linking UNC-A and downtown Asheville
North Carolina Research Campus
New connector roadway
Redevelopment of West Trade Street for retail/mixed use
Waterfront mixed use development in former industrial area
Working on feasibility of parking garages with "air rights"
Riverfront redevelopment and blighted area redevelopment
Construction, including infrastructure to support a manufacturer looking to relocate to this area.

Table 12. TIF Plans by Type of Jurisdiction

Statement that best describes your local gov'ts plan for TIF	County Government		City Government		Council of Government		Other				Total	
	Freq	%	Freq	%	Freq	%	Freq	%			Freq	%
No plans and none in foreseeable future	8	24.2	10	22.7	5	50	5	26.3			28	26.2
No specific plans but won't rule out using it	21	63.6	22	50	3	30	2	10.5			48	44.9
No specific plans now but will use in future	2	6.1	6	13.6	0	0	3	15.8			11	10.3
Project in mind and intend to use it soon	2	6.1	3	6.8	0	0	1	5.3			6	5.6
Begun creating a TIF district for specific project	0	0.0	3	6.8	0	0	2	10.5			5	4.7
Not answered or answer not applicable	0	0.0	0	0.0	02	20	6	31.6			8	8.4
Total	**33**	**100 %**	**44**	**100%**	**10**	**100%**	**19**	**100%**			**106**	**100%**

Question 16 asked: "What types of projects do you think would be good options for TIF?" The responses were grouped into six categories as shown in Table 13.

Table 13. Suggested types of projects for TIF.

Category		Frequency	Percent
Infrastructure		16	15%
Downtown Development Or Revitalization		8	7.5%
Redevelopment		12	11.2%
Business Development		9	8.4%
Negative/Not Answered		61	57%
Other		1	1%
Total		107	100%

Table 14 shows the planned use of TIF by jurisdiction population. Jurisdictions of all sizes represented in the sample with the exception of those in the 250,000 to 500,000 range intend to use TIF or had already begun the process.

Table 14 . Plans for Using TIF By Jurisdiction Size.

Statement that best describes your local gov'ts plan for TIF	Less than 25,000		25,000 to 49,999		50,000 to 99,999		100,000 to 249,999		250,000 to 499,999		Over 500,000		Total	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
No plans and none in foreseeable future	8	21.6	4	36.4	4	23.5	5	26.3	4	36.4	3	50.0	28	27.5
No specific plans but won't rule out using it	21	56.8	6	54.5	7	41.2	9	47.4	4	36.4	1	16.7	48	47
No specific plans now but will use in future	4	10.8	0	0.0	3	17.6	2	10.5	2	18.2	0	0.0	11	10.8
Project in mind and intend to use it soon	3	8.1	0	0.0	3	17.6	0	0.0	0	0.0	0	0.0	6	5.9
Begun creating a TIF district for specific project	1	2.7	1	9.1	0	0.0	1	5.3	0	0.0	1	16.7	5	5
Not answered or answer not applicable	0	0.0	0	0.0	0	0.0	2	10.5	1	9.1	1	16.7	4	4
Total	**37**	**100%**	**11**	**100%**	**17**	**100%**	**18**	**100%**	**11**	**100%**	**6**	**100%**	**102**	**100%**

Although only one TIF project had been approved by June of 2006, interest in tax increment financing seems to be strong in North Carolina local governments. Seventy percent of the respondents had looked into this form of financing economic development. Although few reported having developed guidelines for creating TIF districts, just over ten percent are in the process of creating a TIF district or have already applied to the Local Government Commission for approval. An additional twenty-six percent of the respondents reported that they may attempt to use TIF with the next two years.

As local officials and the public become more familiar with TIF and the procedures for using it, its use may become common. Although respondents noted that the lengthy process for obtaining TIF approval and public perception were major barriers to its use, a majority rated it an effective tool for local governments in North Carolina to use for economic development. A few demonstrated successes may lead to its full consideration. As noted in the national survey data from the ICMA, jurisdictions in the 25,000 to 100,000 population range were the most likely TIF users. North Carolina has many local governments in this population range. And, as the ICM data showed, jurisdictions using TIF were less likely to use a variety of different taxes than were non TIF jurisdictions. North Carolina local governments do not have access to some common taxes such as local income or personal property taxes. This may also predict wide consideration of TIF in the state.

V. NC TIF Process and Resources

This section of the study focuses on the new TIF process in NC, providing both a summary of that process and resources for navigating it. The term "TIF" is used here except where reference to the statutes dictates use of "project development financing." First, the basic process for using TIF in NC is outlined. Then, the legal requirements and guidance for TIF usage in NC are reviewed. This is followed by a comparison of TIF with other public financing tools used in NC. Finally, additional resources are listed.

A. **NC TIF Process Outline**

There are seven (7) basic steps to using TIF in NC:

1. Consult with the NC Local Governments Commission
2. Define the TIF district boundaries ("the Development Financing District")
3. Develop a TIF Plan ("Development Financing Plan"):
    - Define the public investment: nature of the project, detailed costs, sources and amount of funds to pay for the public investment, and term for proposed TIF bonds
    - Describe the anticipated private development
    - Define TIF District's boundaries and base tax revenue, and estimate the anticipated tax increment
    - Describe benefits of the public and private development to TIF District residents and business owners
    - Describe activities to ameliorate potential negative impacts of the project to TIF District residents and business owners
    - Stipulate compliance with statutory manufacturing wage requirements.
4. Request external reviews:
    - County Commission must review and can veto municipal-sponsored TIF Plans
    - NC DENR (Department of Environment and Natural Resources) reviews TIF Plans for environmental impacts of manufacturing
    - NC DOC (Department of Commerce) reviews TIF Plans for manufacturing wage test
5. Hold a Public Hearing, Pass a "but for" resolution, & Adopt the TIF Plan
6. Submit a TIF Application to the NCLGC (Local Government Commission) for TIF Bond Issuance Approval
7. If approved:
    - Notify the County Tax assessor to set the base tax valuation
    - Establish a Tax Revenue Increment Fund
    - Produce annual TIF reports

The Treasury Department estimates the entire process should take 3 months.

B. **Legal Requirements and Guidance for TIF in NC**

On August 7, 2003, Governor Easley signed Senate Bill 725 / S.L. 2003 -403, which provided for an amendment to Article V of the North Carolina Constitution to allow local governments to use Tax Increment Financing (TIF,) pending approval of the constitutional amendment by the voters of the state. The bill also provided specific requirements in the General Statutes to govern use of TIF in NC, should the amendment be passed.

Although the amendment does not use the term "Tax Increment Financing", it explicitly removes obstacles to use of TIF previously present in sections 2 and 4 of Article V (but removes them only for the use of TIF.) It authorizes the legislature, "[n]otwithstanding Section 4 of this Article," to "enact general laws authorizing any county, city, or town to define territorial areas in the county, city, or town, and borrow money to be used to finance public activities associated with private development projects within the territorial areas, as provided in this section." The amendment then spells out the calculation of incremental tax revenues and the securing of debt instruments with those incremental revenues. It also allows the General Assembly, "[n]otwithstanding the provisions of Section 2 of this Article," to enact general laws authorizing local governments to "assess property within the [defined territorial] area at a minimum value if agreed to by the owner of the property."

On November 2, 2004, NC voters approved the amendment to the state Constitution, and upon certification by the State Board of Elections, the amendment and the General Statutes governing TIF usage became effective. A supplementary bill, Senate Bill 528/S.L.2005-407, was signed into law by Governor Easley on September 20, 2005. [105] Copies of the session laws for these two Senate Bills are in the Appendices.

The key TIF provisions created by Senate Bills 725/S.L. 2003-403 and Senate Bill 528/S.L. 2005-407 are found in the NC General Statutes Chapter 159 Sections 101-113 (known as Article 6: Project Development Financing Act), Chapter 159 Section 163.1, Chapter 160A Section 515.1, Chapter 158 Section 7.3, and Chapter 105 Section 277.11:

- Eligible Sponsors:
  - Counties and municipalities may issue TIF bonds.[106]
  - Counties and municipalities may create TIF districts associated with "development projects" under G.S. 158-7.3.
  - Only municipalities may create TIF districts under G.S. 160A-515.1 in a previously-established "redevelopment area".
- Approvals:
  - No citizen referendum is required.[107]

[105] Senate Bill 528/S.L. 2005-407 was introduced to provide an exception to the "20%retail limit" for enterprise tier one areas (as defined in G.S. 105-129.3)
[106] G.S. 159-102 through 159-103.
[107] However, this does not waive the requirement for a referendum if the financing package involves other financing tools for which a referendum is required.

- Approval by the NC Local Government Commission is required.[108]
- If new manufacturing facilities are part of the TIF Plan, then approval by NC DENR and NC DOC is required.[109]
- Counties must review municipal TIF Plans and may veto them.[110]

o TIF Districts:

- Must be designated by adoption of a TIF Plan specifying the boundaries of the proposed district.[111]
- May be associated with either development projects (G.S. 158-7.3) or redevelopment projects (G.S. 160A-515.1):
  - Development projects are defined as those that create net new jobs in the district or within a two-mile radius, and that involve capital expenditures by both local government and the private sector, and that increase the local government tax base.[112]
  - Redevelopment projects are defined under the state's existing Urban Redevelopment Law (G.S. 160A-500 through 526), in redevelopment areas designated by the planning commission.
- If associated with redevelopment as defined in G.S. 160A-503(15), must include "all or portions of one or more redevelopment areas"[113]; which is defined as any area which a planning commission finds to be:
  - A blighted area because of the conditions enumerated in subdivision (2) of section 160A-503; and/or
  - A nonresidential redevelopment area because of conditions enumerated in subdivision (10) of section 160A-503; and/or
  - A rehabilitation, conservation, and reconditioning area within the meaning of subdivision (21) of section 160A-503;

[108] G.S. 159-104 through 159-106.
[109] G.S. 160A-515.1(d) and (f) for redevelopment projects. Subsection (d) contains the "wage test", requiring that DOC either exempt the TIF Plan or find that it meets the wage test (that the average weekly wage will be above the county average or at least ten percent above the statewide average.) Subsection (f) requires DENR to apply G.S. 159C-7's standards for determining whether a facility's construction or operation will have a "materially adverse effect" on the environment and to determine whether the company that will operate the facility has complied with environmental requirements in operating other facilities. These requirements are repeated at G.S. 158-7.3(e) and (g) for development projects.
[110] G.S. 160A-515.1(e) for redevelopment projects and G.S. 158-7.3(f) for development projects.
[111] G.S. 160A-515.1(a) and (c)(1).
[112] G.S. 158-7.3(a)(1)
[113] This requirement is found at G.S. 160A-515.1(b). Note that "redevelopment areas" are defined in Article 22 of Chapter 160A, at Section 503 subsection (16). "Blighted area" and "non-residential redevelopment area" are defined by very similar but not identical conditions; "blighted" refers to areas including residential and "non-residential" refers to predominantly non-residential areas. "Rehabilitation, conservation and reconditioning area" are an area that is likely to become a blighted or non-residential development area unless action is taken.

- If associated with a development project, must meet at least one of these criteria[114]:
  - "blighted, deteriorated, deteriorating, undeveloped, underdeveloped or inappropriately developed from the standpoint of sound community development and growth"
  - "appropriate for rehabilitation or conservation activities"
  - "appropriate for the economic development of the community"
- May not exceed 5% of the total land area of the sponsoring local government's jurisdiction.[115]
- If associated with a development project, may not include more than 20% retail land usage unless the TIF district is either in an enterprise tier one area or in a Central Business District.[116]
- Counties may only define TIF districts in the unincorporated portion of their jurisdictions, although they may join with municipalities in creating such districts within municipal boundaries.[117]

o TIF Bonds:

- Cannot have a term longer than 30 years after the effective date of the TIF district.[118]
- Can only be used for the same kinds of projects for which the local government is authorized to use general obligation bonds as identified in G.S. 159-48[119]:

1. Airports;
2. Hospitals and other health care facilities;
3. Low and Moderate Income Housing;
4. Industrial Development;
5. Civic, Cultural and Entertainment facilities (excluding libraries, parks, and government buildings such as for law enforcement, courts, or offices);
6. Railroad corridor preservation;
7. Storm water and flood control systems, water systems, and sewer systems;

[114] G.S. 158-7.3(c).
[115] G.S. 160A-515.1(b) and G.S. 158-7.3(c)(3).
[116] G.S. 158-7.3(a)(1). Note that "central business district" is as "defined by resolution of the city council", and that the limit applies to floor space in "retail sales, hotels, banking, and financial services offered directly to consumers, and other commercial uses other than office spaces".
[117] G.S. 158-7.3(b) and (c).
[118] G.S. 159-112. Note that the term of TIF bonds may not exceed the "maximum period of usefulness" of the project being financed (as prescribed by the Local Government Commission under G.S. 159-122) if that is less than 30 years from the TIF district effective date.
[119] G.S. 159-103(a). Note that this subsection references G.S. 159-48 subdivisions (b)(1), (3), (7), (11), (12), (16), (17), (19), (21), (23), (24), or (25), (c)(4a) or (6), or (d)(3), (4), (5), (6), or (7), and, where the financed project is in a municipal service district, G.S. 160A-536.

8. Bringing streets up to state standards (paying counties' local share of improvements costs)
9. Public Transportation and Parking;
10. Redevelopment under the Urban Redevelopment Law;
11. In addition, municipalities may use TIF for these purposes that are not authorized to counties unless undertaken jointly with a municipality:
    - Streets and sidewalks;
    - Electric systems and gas systems;
    - Telephone systems;
    - Purposes for which municipal service districts are allowed.

- TIF Plans
  - Must include all of the following ten items[120]:
    1. District Boundaries: A description of the boundaries of the development financing district.
    2. Proposed Development: A description of the proposed development of the district, both public and private.
    3. Costs: The costs of the proposed public activities.
    4. Funds: The sources and amounts of funds to pay for the proposed public activities.
    5. Base Valuation: The base valuation of the development financing district.
    6. Projected Incremental Valuation: The projected incremental valuation of the development financing district.
    7. Duration: The estimated duration of the development financing district.
    8. Benefits: A description of how the proposed development of the district, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, or services.
    9. Negative Impacts Amelioration: A description of the appropriate ameliorative activities which will be undertaken if the proposed projects have a negative impact on residents or business owners of the district in terms of jobs, affordable housing, services, or displacement.
    10. Manufacturing Wage Requirement: A requirement that the initial users of any new manufacturing facilities that will be located in the district and that are included in the plan will comply with the wage requirements referred to in sections 160A-515.1 and 158-7.3.
  - In addition, if the Plan is for a redevelopment project, it must be compatible with the redevelopment plan created under the Urban Redevelopment Law (Chapter 160A, Article 22).

[120] G.S. 158-7.3(d)(1) through (10) for development projects. The identical list of ten items applies to redevelopment projects and is found at G.S. 160A-515.1(c)(1) through (10).

The Secretary of the Treasury has issued guidance for the process of seeking TIF approval from the NC Local Government Commission[121]. The guidance traces the steps shown above in the process outline, and identifies the findings required in the statutes for LGC approval of the TIF Bonds[122]:

1. The proposed Project Development Financing is necessary to secure significant new project development for a development financing district.
2. The amount of the issue is adequate and not excessive.
3. The proposed projects are feasible (i.e., the incremental tax revenues, and other security pledged, if any, will be sufficient to pay the proposed debt.)
4. The local government practices sound debt management.
5. The private development forecast in the DFP would not occur but for the public projects financed by the Project Development Financing (as determined by local government resolution.[123])
6. The proposed debt can be marketed at reasonable interest cost to the local government.
7. The local government has adopted a Development Financing Plan (DFP) conforming to G.S. 158-7.3(d) or G.S. 160A 515.1(c).

C. **Public Finance in NC**

Local governments in NC have an array of public financing tools at their disposal that have often been used in projects for which TIF might have been used in other states. How does TIF as a new public financing tool stack up against these existing tools? The following discussion reviews those tools and compares them to TIF.

The four most frequently-used financing methods for local governments in NC are:

- General Obligation Bonds,
- Special Obligation Bonds,
- Revenue Bonds, and
- Installment Purchase Contracts (and related Certificates of Participation.)

Table 15 provides a comparison of TIF with these financing methods and one other method called "Synthetic TIF". Each method is briefly defined and its benefits and constraints discussed. Other public financing methods used in NC but not specifically relevant for comparison with TIF bonds and thus not addressed in this document include capital leases, loans from the state, and capital appreciation bonds.

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[121] See http://www.treasurer.state.nc.us/NR/rdonlyres/26DF90C8-DF73-4AAF-9832-3830EA07B089/0/AmendmentOnedraftrevised9205.pdf *[remove line break if pasting into browser]*

[122] G.S. 159-105(b) subdivisions (1) through (7).

[123] Per the LGC's issued guidelines for TIF approval, the LGC intends to rely on the local government's "but for" resolution to satisfy this legislative requirement of findings unless there is concern about the project's feasibility, in which case a referendum may be required.

Table 15. Comparison of Public Financing Methods

	Financing Method					
Characteristic	**General Obligation Bond (GOB)**	**Special Obligation Bond (SOB)**	**Revenue Bond (RB)**	**Installment Purchase Contracts (IPC)**	**"Synthetic" TIF**	**Tax Increment Financing (TIF)**
Citizen referendum	Required for most bonds; also 2/3 rule	Not required	Not required	Not required	Not required	Not required
Local Gov't. Commission	Approval Required	Approval Required	Approval Required	Varies by purpose, amount & term	Not required	Approval Required
Debt Service Sources	General revenues, backed by a pledge of the taxing power of local government	Sources other than taxing power (e.g., revenues from the financed project, or state disbursements)	Revenues from the financed project	General revenues Two or three party contracts with bank(s)	General revenues, based on incremental tax revenues from the agreed-upon project area	Incremental tax revenues from the TIF District
Amount restriction	Total net debt[124] must be less than 8% of local assessed valuation	No limit	No limit	Total net debt[125] must be less than 8% of local assessed valuation	No limit	No limit
Length restriction	Generally 40 years max., but varies by project type	Similar to GOB	Similar to GOB	Similar to GOB	No limit	30 years maximum
Eligible Purposes	Broad range of purposes -- G.S.159-58 (a)-(i)	Solid waste management only	Public facilities and infrastructure	Assets acquisition, construction or repair	Public facilities and infrastructure	Public facilities and infrastructure
Municipal vs. County	Different purposes authorized	No difference	No difference	No difference	Only as to general authority to acquire or operate public facilities or infrastructure, not as to financing	Different purposes authorized
Bond Security	High	Medium	Medium	Medium	Not applicable	Medium
Other Comments	Must be issued within seven years of bond order			May be more cost-effective than bonds on smaller project	Requires developer willing to assume risk and able to find private financing	Maximum area 5% of jurisdiction district

[124] including both GOB and IPC debt
[125] including both GOB and IPC debt

General obligation bonds (GOBs)are backed by the full faith and credit of the issuing government and its pledge to use its taxing power if needed to repay the bond debt. They must be approved by local voters through a ballot referendum. They may be used for a wide variety of purposes and for terms up to 40 years. The amount of debt incurred is limited by an overall debt ceiling of 8% of tax revenues that includes prior GOB debt and Installment Purchase Contract debt. The combination of that flexibility and the low interest rate incurred by the "full faith and credit" rating makes them among the most utilitarian of public financing methods, save for the time required and uncertainty surrounding obtaining voter approval. TIF bonds would expect to incur a higher interest rate than GOBs, but to have a quicker and possibly more assured approval than GOBs.

Special obligation bonds (SOBs)are not backed by a pledge of the local government's taxing power, but are instead backed by a pledge of either the anticipated revenues from the financed project itself or other revenue sources available to the local government (such as its share of state sales taxes.) However, the risk of default is perceived by underwriters as virtually the same as for GOBs, hence they carry only a small risk premium over GOBs in interest rates. There is no limit to the term or amount of special obligation bonds, and LGC approval is required instead of a citizen referendum. They are restricted in their purposes, though, to solid waste management facilities. TIF bonds would expect to incur a slightly higher interest rate than SOBs, although the same perception of very low risk of default may mitigate that. For solid waste management projects that do not involve other public investment and do not have the potential to attract significant private development, SOBs would seem a better financing tool than TIF bonds.

Revenue bonds (RBs) are similar to special obligation bonds in that they are backed by a pledge of the anticipated revenues from the financed project itself, rather than the general taxing power. As with SOBs, there is no limit to the term or amount of the bonds, and LGC approval is required instead of a citizen referendum. They are different from SOBs in that sources of revenue other than revenue from the financed project itself may not be used. They also differ from SOBs in that they may be used for a wide variety of public facilities and infrastructure, not just solid waste management projects. The choice between RBs and TIFs may come down to an analysis of the anticipated revenue stream from the financed project itself versus the potential tax increment if significant private development is anticipated to follow the public investment.

Installment purchase contracts (IPCs) are not strictly speaking "bonds". They are purchase contracts that are not backed by either a pledge of the general taxing power or other sources of local government revenue (including revenue from the financed project itself.) They are often secured by the asset being purchased, just as an installment loan is, and in fact, banks are most often the holders of IPCs with local governments. No citizen referendum is required for local governments to enter into IPCs, but LGC approval may be required depending on the amount, term, and purpose of the IPC. Local governments may not enter into IPCs that would increase their total GOB and IPC debt beyond 8% of their total tax revenues. When the amount of an IPC is large enough that one financial institution would not wish to handle it alone, the loan is "certificated" or converted to "Certificates of Participation" (COPs) in which each lending institution has a share. IPCs

are generally used for projects that are smaller in both amount and duration than any of the bonds are used for. Until the administrative hurdles of TIF are well understood in NC, local governments are likely to continue using IPCs and COPs for projects not large enough to warrant a TIF bond approval process.

Synthetic TIF is the term coined for an approach to public financing that has some similarities to TIF but that does not depend on the amendment to the state Constitution and the issuance of bonds backed by an anticipated increment in tax values. Synthetic TIFs can take a variety of forms. One example is where the developer agrees to finance and construct the public facilities or infrastructure, and the local government agrees, contingent upon sufficient increase in tax valuation over time, either to acquire the completed facilities or to make an economic development grant to the developer to cover the project costs. Thus, the risk that the tax increment will be sufficient to cover the project costs is borne by the developer rather than the local government. The local government may pay the developer out of general funds or issue debt, knowing that the incremental tax revenue is available to meet the payment obligation.

D. **Additional Resources for TIF in NC**

In the months since Amendment One passed and legislation governing TIF was enacted, many resources have emerged to guide local governments and real estate development professionals in using TIF bonds in NC. This is a list of those the researchers have found most helpful, and does not claim to be all-inclusive or comprehensive:

A. North Carolina Local Government Commission Guidelines [titled, "Amendment One: Project Development Financing 9/2005"], at http://www.treasurer.state.nc.us/NR/rdonlyres/26DF90C8-DF73-4AAF-9832-3830EA07B089/0/AmendmentOnedraftrevised9205.pdf [*remove linebreak if cutting and pasting into browser*]

B. "Forum for Progress: North Carolina Self-Financing Bonds", a forum on TIF sponsored by Kennedy Covington, Attorneys at Law, December 2, 2004

C. "Approval Process for Project Development Financing Bonds", a presentation by James Baker, Asst. Director of Debt Management, State and Local Government Finance Division, Department of the State Treasurer, at the October 2005 annual conference of the NC Chapter of the American Planning Association

D. "North Carolina Project Development Financing", a publication by Josiah C.T. Lucas and Brenton D. Jeffcoat of McGuireWoods, October 2005

E. "Project Development Financing", a presentation by David Lawrence, Institute of Government, at the October 2005 annual conference of the NC Chapter of the American Planning Association

F. Self-Financing Bonds: Recommended Criteria and Process by City of Charlotte & Mecklenburg County

G. Suggested Considerations for Tax Increment Financing in North Carolina (Draft, 3/28/05), by the North Carolina Chapter of The American Planning Association

VI. The Economic Model to Analyze a TIF Project or District

For the government's TIF investment to be economically efficient, i.e., wealth enhancing to the citizens, the following must hold:

The present value of the increase in property taxes *after* the TIF investment

minus

the present value of the increase in property taxes that might occur *without* the investment[126]

must be greater than

the TIF investment[127]

Thus, in order to determine the economic feasibility of the government's investment in a TIF district (or for an individual TIF project), it is necessary to carefully and realistically examine the economics of the private real estate market in which the project resides and the developers' economic decision making-process given this market. The TIF investment must be such that the private market responds adequately with construction, leasing and sales that can be expected to increase incremental tax revenues within the district.

For a given project or district, it will be necessary to determine the expected amount, value, and timing of construction and sales activity, which then translates into a property tax cash flow stream over time. This analysis must be done for the area or project both with *and* without the TIF investment. The incremental difference in the property tax cash flows must then be compared to the debt service on the TIF bonds to see if the investment is economically viable and that the bonds can be timely paid.

Before detailing the model, we will summarize here the inputs that will be needed to run the model and outputs that will result. An understanding of the model will be crucial to understanding the nature of the inputs and outputs listed below.

[126] The present value of the increase in property taxes after the TIF investment minus the present value of the increase in property taxes that might occur without the investment can be viewed as the *marginal* increase in property tax revenues.

[127] The benefits of the TIF investment may extend beyond the marginal increase in property tax revenues. For example, the investment may provide "supplemental benefits" or "indirect benefits" such as spillover effects, an effect on sales tax revenues, etc. The model developed here will be a good first pass at an analysis that can determine if the TIF district or project t is likely to provide enough benefits through property taxes alone to merit investment. If the project does not pass the first test provided by the model, additional supplemental benefits may be considered to potentially justify investment. Note that these supplemental benefits, while real, are often very hard to quantify.

Inputs (with and without TIF Investment):

- Number of buildings/homes to be built on each parcel within the TIF district
- Current and long-term lease prices/residential service flow
- Growth rate and price reversion parameters for the commercial lease price or residential service flow processes
- Volatility of the commercial lease price or residential service flows
- Presale process, both pre and post-construction
- Long-term treasury Rate
- Arrival and departure process (absorption) for prospective tenants/homebuyers
- Demand elasticity in the market
- Costs of holding the land or completed project
- Construction costs and construction time to develop

Outputs (all computed with and without TIF Investment)

- Land values and completed project values
- Presale requirements to begin construction
- Expected time to begin development and complete construction
- Equilibrium lease rates and/or home prices at which development will occur
- Expected market absorption of space or units
- Expected property tax revenues over time
- A determination of the economic efficiency of the TIF investment for the funding tax districts

In the appendix, we describe the intricacies of the economic model that we have developed. It is a model of the private real estate and development decision-making process. This is the model that will be used to examine quantity and timing of development, along with the values of land and completed development projects. From this information we will be able to predict property tax cash flows for the TIF district and determine the potential for the economic efficacy of the government's investment.

VII. TIF Scenarios

In addition to legal criteria required by the North Carolina General Statutes, the researchers have drafted other criteria for structuring a successful TIF program, that can be used both for designing the TIF scenarios for economic modeling anticipated in Phase II of the study, and by local governments as a guide in using TIF. These criteria are drawn from the review of other states' experience with TIF and from the stakeholder interviews with local economic developers, lawyers, and local government officials. The resulting criteria fall into three categories: those related to the local government Sponsor, those related to selecting appropriate Sites or Areas for TIF districts, and those related to the actual TIF Projects themselves.

Sponsor:

- The Sponsor should have a clear policy goal for shifting development opportunities from one area or site to another within its jurisdiction.
- The Sponsor should be in relatively stable/healthy financial condition
- The Sponsor should be close enough to its General Obligation Bond (GOB) cap to not want to add to it, but not so much in debt as to create financial instability.
- Small towns and/or municipalities with a low property tax rate may not be suitable Sponsors for TIF, due to:
  - 5% land area limit
  - Costs of bond insurance
  - Small amount of incremental tax revenues potentially available.
- Sponsors that are not eager to grow via annexation but would prefer to focus on redevelopment within existing jurisdiction for future growth may find TIF to be useful.

Site:

- Sites or areas that may provide additional economic development opportunity outside the TIF district, as a "spillover" effect.
- Non-Industrial sites or areas: Economic development incentives for relocation of industrial sector sites may conflict with TIF.
- Degree of blight: Accurate estimation of future tax revenues for coverage of bond debt service may depend on how economically challenged the area is presently. Sites of moderate to strong stability may not need TIF in order to attract redevelopment, while those that are severely blighted may have very high uncertainty regarding their ability to attract additional development and increase tax revenues even with the TIF public investment.

Projects:

- TIF can assist lower priority investments such as streetscape improvement.
- Public investment can make private projects financially viable through long term

and upfront financing.

- Projects that need expedited financial approval may be better suited for TIF, as opposed to utilizing GOB.
- Project financing lasting longer than 5 years will be better suited for TIF. (Installment Purchase Contract might be a better financing tool if the project financing needed is less than five years.)
- Projects for the manufacturing employment sector may not be suited for TIF.
  - Manufacture wage test trigger
  - Incentive grants for the manufacturing sector may conflict with TIF
- 20% retail limit outside Central Business District (CBD) or enterprise tier one areas is a big constraint in applying TIF.
- Projects incorporating mixed-use or office space development are generally more financially predictable, and thus more feasible as potential TIF projects.
- Potential TIF projects may include transit stations or housing other than low density single-family housing.

VIII. Stakeholder Workshop

A. Workshop Information

The TIF workshop was held on June 27th, 2006 at the UNC Charlotte Uptown location. Researchers from the UNC Charlotte Center for Real Estate, the UNC Charlotte Urban Institute, and the Political Science Department presented the results from the first phase of a study on TIF as a new financing tool in North Carolina. Approximately 16 professionals from various sectors attended the workshop, including Non Profit, Real Estate, Government, and Legal professions.

Roundtable participants also included various professionals in government, legal, and real estate sectors. The roundtable members who attended were Clay Andrews from Cabarrus EDC, Tony Crumbley from the Charlotte Chamber, and David Jones from Kennedy Covington. (Three individuals who had agreed to participate as roundtable members had last-minute conflicts that prevented their attending the workshop.)

The research staff from this workshop included Steve Ott from the UNC Charlotte Center for Real Estate, Vicki Bott from the UNC Charlotte Urban Institute, Gary Rassel from the UNC Charlotte Political Science Department, and Dustin Read from the UNC Charlotte Public Policy PhD program.

B. Agenda and Format

The general format of this event was "present and discuss", where the researchers presented their findings to the attendees and roundtable members, then the roundtable members posed questions and offered comments. After the roundtable members asked questions and commented, the floor was opened for attendees to ask questions and comment on the research findings. The workshop opened with introductions and a review of the study's purpose and goals, followed by presentation and discussion of each of the six major components of the research:

a. Literature review
b. Public finance officers survey
c. Key practitioners interviews
d. TIF economic model design
e. Draft TIF Guidelines document
f. TIF Scenarios design

C. Highlights from Discussion

Key Questions, Answers and Comments from Roundtable members and Audience

Questions and Answers

Q: How big is the spread in interest rates between GOB and TIF bonds?
A: 25-50 basis points, but as experience with TIF grows, the spread is expected to shrink, same as has happened with other bonds not backed by the full faith and credit that nevertheless local governments are extremely reluctant to default on.

Q: Why is TIF usage lowest in the Northeast?
A: There is no specific answer indicated from the survey, but the NE tends to do less economic development in general, so TIF usage follows economic development patterns, which could explain it.

Q: Is there any discernable pattern to legislation across the states?
A: Don't know, but expect Midwest and West Coast states have less restrictive legislation than those states that followed later.

Q: Is residential development allowed as part of TIF projects?
A: Short answer is "yes", but the longer answer is that the math doesn't support much residential in re-development projects, and for development projects, the requirement that the project "must generate jobs" is tougher to do if the project is heavily residential and falls under the 20% retail limit.

Q: What is "Synthetic TIF"?
A: It can be called "Reverse TIF" as compared to "Statutory TIF". In statutory TIF, the local government borrows money upfront, invests it in the public portion of a development project, and then pays the debt back with tax increment money. In synthetic or reverse TIF, the developer borrows the money upfront and invests it in the portion of the project that has a "public" component, and then the local government either purchases the public component from the developer or makes an economic development grant to the developer, using incremental tax revenues as the funding source for the purchase or grant. The big difference is which party does the borrowing and assumes the risk that there will be no incremental revenues.

Q: What happens if there are more incremental tax revenues than are needed to pay off the debt?
A: The LGC is going to require a debt to service ratio of about 1.2 to 1.5 in order to approve a TIF Plan, so there likely will be additional funds.

Q: What constitutes redevelopment?
A: Development projects are defined as those that create net new jobs in the district or within a two mile radius, and that involve capital expenditures by both local government and the private sector, and that increase local government tax base, while redevelopment projects are defined under the state's existing Urban Redevelopment Law (G.S. 160A-500 through 526), carried out by a local

governing body (or its redevelopment commission or housing authority), in redevelopment areas designated by the planning commission, according to a redevelopment plan approved by the local governing body.

Comments

- NC statutes were written to address many of the points made in the literature; e.g., county review and veto; fair sharing of revenue increment with the county
- Interesting to note the statewide survey finding that TIF will replace general fund monies; this would likely be true as more local governments find their budgets are strapped and they are having to consider tax increases; TIF can relieve some of that budget pressure
- It would be helpful to have the analysis extend beyond the basic feasibility question to include "supplemental benefits", such as spillover effects, effect on sales tax revenues, etc. Showing a quantitative analysis of feasibility may be too constraining.
- It seems that Synthetic TIF would be preferred to statutory TIF for smaller projects.
- The 20% retail limit only applies to development projects, not re-development projects
- The 5% limit on TIF may be too binding for smaller governments because of their small land area.
- The manufacturing wage test may be removed from the statutes at a later date. The requirement has been taken out of legislation for Industrial Development Bonds and the Local Governments Commission wants it to be taken out of the TIF legislation.
- Development around transit stations and corridors is not a given for TIF. It appears that TIF districts are eligible around transit stations but getting them approved may depend on the plan developed for the TIF.
- Single family residential housing developments may not be good candidates for TIF, because in most cases single family housing does not have the density necessary to generate sufficient increase in tax revenues to justify the TIF investment.

Suggested Statutory Changes

When asked what changes to the NC TIF statutes might be helpful, the roundtable members and attendees offered these suggestions:

- Eliminate the "sampling of G.O. Bond" permitted TIF purposes and create a list of permitted purposes specifically designed for TIF, for instance to allow remediation of brownfields as a permitted TIF purpose.
- Clarify and unify the "development projects" versus "re-development projects" distinctions in the TIF statutes to make it easier to figure out how to do TIF.

IX. Conclusions & Next Steps

A. Conclusions

When carefully and appropriately used, TIF can be a useful economic development and public financing tool. It allows local governments to control the development process for areas that otherwise would likely not receive needed private sector investment in economic development. It provides them with a means of funding the public portion of the economic development investment that neither raises the general property tax rate nor requires a ballot referendum.

The experience of other states with TIF provides valuable lessons for using TIF in North Carolina. Many of the lessons from other states' experience with TIF have been incorporated in North Carolina's TIF laws enacted in 2004. A multi-step process is prescribed for state approval of TIF bonds that includes specific requirements for and limitations on designation of TIF district boundaries, adoption of a written TIF plan, and types of projects that can be funded using TIF.

Key regional practitioner interviews provided much helpful insight into current perceptions of TIF and intent to use TIF. The national ICMA survey data and the statewide survey conducted by the researchers also yielded useful perspective on TIF in NC. Based on the statewide survey results, interest in TIF seems to be strong and growing in North Carolina local governments.

The lower-than expected volume of TIF applications to the NC Local Government Commission appears to be explained by a combination of the factors anticipated by this study:

- The learning curve for using TIF is steep:
  - the NC approval process is perceived as uncertain and complex;
  - TIF is an inherently riskier tool than many other public financing tools, making reliable evaluation of TIF feasibility a critical capability that NC governments must acquire (through tools such as economic models and through expertise either internal or in hired consultants); and
- Not all projects will prove to be a good fit for TIF, and some projects may be a better fit for the alternative financing tools that have grown up in the absence of TIF.

These factors suggest that TIF usage in NC will naturally increase over time as the first few projects emerge from the NC TIF process and local governments and the private sector gain experience in navigating that process, determining TIF "fit", and in assessing TIF feasibility.

The results of the first phase of this study should assist with this process. The economic model developed by the researchers in this first phase of the study may prove to be a significant aid in assessing feasibility, while the NC TIF Process guidelines developed in this study should provide a useful first step towards determining TIF fit and navigating NC's process.

There are also some changes to the NC TIF laws that could enhance TIF usage in North Carolina:

- Replace the mix of TIF permitted uses currently drawn from existing General Obligation Bond permitted uses with a TIF-specific list of permitted uses.
- Examine whether a standard for small jurisdictions other than the current 5% of total land area cap on TIF districts is appropriate.
- Remove the manufacturing wage test requirements.
- Clarify the distinctions and similarities between "development" and "redevelopment" TIF projects to improve comprehensibility.

The economic model developed in this phase of the study was positively received by stakeholder workshop attendees as requiring a manageable set of input data and providing a comprehensive and useful set of output data for assessing TIF feasibility.

The workshop participants pointed out that the model explicitly does not assess more intangible aspects of assessing TIF projects that they identified as important factors in deciding whether to pursue a TIF project. These included indirect costs or savings from social impacts of a TIF project, such as reduced crime and improved social fabric in a neighborhood receiving public infrastructure investments, or the neglect of smaller neighborhood improvement projects if larger TIF projects consume staff time at the expense of those smaller projects. This is an area for further research.

B. Next Steps

Based on the results of the first phase of the study, the researchers intend to proceed with the second phase of the study in which specific potential TIF projects (or "scenarios") will be evaluated using the economic model developed in Phase I. In addition to securing additional funding to allow completion of the study, Phase II will involve these major components:

A. Select scenarios for economic model testing

B. Gather scenario data required as input to economic model

C. Conduct economic model runs

D. Assess results of scenarios economic modeling

E. Present results at regional stakeholder workshop and gain stakeholder feedback

F. Document and publish final study results

The scenario selection process will include a review of all potential TIF projects or scenarios suggested by stakeholders at the Phase I workshop as well as others identified by the researchers. The researchers' aim will be to identify 3-4 scenarios that represent a range of characteristics (type and size of project, type and size of site, etc.) such that the modeling results can enhance regional understanding of factors influencing economic feasibility of TIF projects. Another criterion for scenario selection will be availability of

the required input data and the project sponsors' willingness to permit the results of the modeling to be published at the planned Phase II workshop and through other public media.

The researchers envision working closely with the sponsors of the projects selected as scenarios to gather the relevant data about the projects needed for input to the economic model. These sponsors may be either public or private sector entities, or a combination of both for each selected scenario.

Once the scenario data has been obtained, model runs will be conducted and results assessed by the researchers and prepared for presentation to regional stakeholders at a workshop. In addition to allowing stakeholders to review the modeling results and see how varying the characteristics of potential TIF projects influences the projects' feasibility, the workshop will also provide an opportunity for stakeholders to evaluate the utility of the economic model for practical decision-making regarding the feasibility of TIF projects and give feedback to the researchers for refining the model.

Following the stakeholders workshop, the final results, including stakeholder feedback, will be published on UNC Charlotte websites, submitted for publication in academic journals, and made available to other public media.

Appendix A

Regional Stakeholder Interviewees

Clay Andrews
Recruiter
Cabarrus EDC

Bob Bertges
Senior Vice President
Corporate Real Estate
Wachovia Corp

Tony Crumbley
Vice President
Research & Economic Development
Charlotte Chamber of Commerce

Tom Flynn
Economic Development Director
City of Charlotte

Clay Grubb
President
Grubb Properties

Donnie Hicks
Executive Director
Gaston County EDC

David Jones
Attorney
Kennedy Covington Lobdell &
Hickman, LLP

Jon Kessler
Principal
Banc of America Securities, LLC

Barry Matherly
Executive Director
Lincoln Economic Development Assoc.

Todd Mansfield
CEO
Crosland Corporation

Ryan McDaniels
Director
Cabarrus EDC

Terry Orell
Interim Director
Greater Statesville Development
Corporation

Stephen Turner
Director of Economic Development
City of Rock Hill

Appendix B

North Carolina Tax Increment Financing Survey
March 31, 2006

1. Which best describes your jurisdiction or affiliation?

33 (30.8%)	County government
44 (41.1%)	City government
10 (9.3%)	Council of Governments (COG)
19 (17.8%)	Other : (specify)
1 (0.9%)	Not answered or answer not applicable

2. What is the population of your jurisdiction?

23 (21.5%)	Under 10,000
14 (13.1%)	10,000 – 24,999
11 (10.3%)	25,000 – 49,999
17 (15.9%)	50,000 – 99,999
19 (17.8%)	100,000 – 249,999
11 (10.3%)	250,000 – 499,999
6 (5.6%)	Over 500,000
6 (5.6%)	Not answered or answer not applicable

3. Which department or function best describes your current position?

51 (47.7%)	Finance/Accounting
19 (17.8%)	Economic development
12 (11.2%)	City/county manager's office
7 (6.5%)	Planning
6 (5.6%)	Planning – government organization
7 (6.5%)	Planning – private organization
2 (1.9%)	Other (please specify)
3 (2.8%)	Not answered or answer not applicable

4. Does your jurisdiction have a formal economic development program?

75 (70.1%) Yes 24 (22.4%) No 8 (7.5%) Not answered or N/A

4a. If yes, what is the nature of the program?

24 (22.4%)	Department of local government
28 (26.2%)	Nonprofit development corporation or commission
11 (10.3%)	Public/private partnership
12 (11.2%)	Other (Please specify)
32 (29.9%)	Not answered or answer N/A

5. Do you believe TIF is likely to be an effective economic development tool for local governments in North Carolina?

59 (55.1%)Yes 15 (14.0%)No 26 (24.3%) Not sure

7 (6.5%) Not answered or answer N/A

6A. What do you see as the most important benefits to local governments in North Carolina being able to use TIF? (Mark two of the following).

53 (49.5%)Provide another incentive tool to attract new business
16 (15.0%)Provide a tool to help overcome local fiscal stress
11 (10.3%)Assist in improving existing infrastructure
15 (14.0%)Assist in financing the redevelopment of blighted or abandoned areas
3 (2.8%) Ease pressure on general obligation debt
2 (1.9%) Other (Please specify)
7 (6.5%) Not answered or answer N/A

6B. What do you see as the most important benefits to local governments in North Carolina being able to use TIF? (Mark two of the following).

8 (7.5%) Provide a tool to help overcome local fiscal stress
12 (11.2%) Assist in improving existing infrastructure
34 (31.8%) Assist in financing the redevelopment of blighted or abandoned areas
13 (12.1%) Ease pressure on general obligation debt
3 (2.8%) Other (Please specify)
37 (34.6%) Not answered or answer N/A

7. What do you see as the biggest concern with regard to using TIF?

12 (11.2%)It is a risky economic development tool
30 (28.0%)Public perception of TIF
30 (28.0%)Process is excessively complicated and time consuming
24 (22.4%)More effective alternatives to TIF are available
8 (7.5%)Local government will misuse/overuse TIF
17 (15.9%)Belief that TIF will not bring the economic benefit promised

8. Has anyone in your organization taken steps to learn more about TIF?

76 (71%)Yes 27 (25.2%)No 4 (3.7%) Not answered

9. If yes, which of the following steps were taken? (Mark all that apply)

56 (52.3%)Attended workshops or conferences on TIF
22 (20.6%)Met with officials from other local governments about TIF
30 (28.0%)Met with attorneys/law firms that specialize in TIF
39 (36.4%)Researched the TIF legislation
21 (20.6%)Met with Local Government Commission staff about TIF

10. Have you hired staff to work on TIF related issues or projects?
    2 (1.9%) Yes 100 (93.5%)No 5 (4.7%) Not answered

11. Has your local government established policies or guidelines for using TIF?

    7 (6.5%)Yes 93 (86.9%)No 1 (0.9%) Don't Know

    6 (5.6%) Not answered or answer N/A

12. What do you think is likely to be the most effective use of TIF in North Carolina?

    34 (31.8%)Installing or improving infrastructure to encourage development of an area
    26 (24.3%)Using it as an incentive to attract a major project or company to the jurisdiction
    18 (16.8%)Assisting in the financing of a project already in the planning or production stages
    30 (28.0%)Revitalizing a blighted area of the jurisdiction

13. Please select the statement that best describes your local government's plans for TIF.

    28 (26.2%)We do not have plans to use TIF and probably will not use it in the foreseeable future.
    48 (44.9%)We do not have specific plans at the present time but will not rule out its use in the future.
    11 (10.3%)We do not have specific plans at the present time to use TIF but intend to use it for a future project.
    6 (5.6%)We have a project in mind and intend to use TIF as soon as is practical.
    5 (4.7%)We have begun to create a TIF district for a specific project (Or have approval for a TIF district).
    9 (8.4%) Not answered or answer N/A

14. What types of projects do you think would be good options for TIF?
    (See attachment)

15. Are any of the following projects possibilities for your jurisdiction? (Mark all that apply).

    23 (21.5%) Streetscaping
    53 (49.5%) Downtown development/redevelopment
    36 (33.6%) Renovation of existing facilities
    36 (33.6%) Renewal or renovation of a blighted area
    24 (22.4%) None of the above

16. Is TIF being seriously considered for a current or proposed project in your jurisdiction?

    16 (15.0%)Yes 80 (74.8%)No 3 (2.8%) Don't Know

    8 (7.5%) Not answered or answer N/A

16a. If yes, please give a brief description of the project.
(See attachment)

17. If you are not currently considering projects for TIF, how likely is it that you will do so in the next two years?

5 (4.7%)	Very likely
23 (21.5%)	Likely
22 (20.6%)	Not likely
22 (20.6%)	Very unlikely
18 (16.8%)	Unsure
17 (15.9%)	Not answered or answer not applicable

18. How serious a barrier is each of the following items in utilizing TIF in your jurisdiction? Please rate each item according to the following scale:

A. Public perception

1: A serious barrier	31 (29.0%)
2: A slight barrier	28 (26.2%)
3: Not a serious barrier	24 (22.4%)
4: Not a barrier at all	8 (7.5%)
5. Not answered or answer N/A	16 (15.0%)

B. Lack of knowledge regarding TIF

1: A serious barrier	32 (29.9%)
2: A slight barrier	32 (29.9%)
3: Not a serious barrier	21 (19.6%)
4: Not a barrier at all	6 (5.6%)
5. Not answered or answer N/A	16 (15.0%)

C. Lack of focus on economic development in the jurisdiction

1: A serious barrier	9 (8.4%)
2: A slight barrier	16 (15.0%)
3: Not a serious barrier	28 (26.2%)
4: Not a barrier at all	38 (35.5%)
5. Not answered or answer N/A	16 (15.0%)

D. Lack of a large scale project that can utilize TIF

1: A serious barrier	33 (30.8%)
2: A slight barrier	19 (17.8%)
3: Not a serious barrier	16 (15.0%)
4: Not a barrier at all	21 (19.6%)
5. Not answered or answer N/A	18 (16.8%)

E. Lack of political support for TIF

1: A serious barrier	12 (11.2%)
2: A slight barrier	32 (29.9%)
3: Not a serious barrier	31 (29.0%)
4: Not a barrier at all	15 (14.0%)
5. Not answered or answer N/A	17 (15.9%)

F. Jurisdiction has alternative financing options available that are more attractive than TIF

1: A serious barrier	27 (25.2%)
2: A slight barrier	27 (25.2%)
3: Not a serious barrier	19 (17.8%)
4: Not a barrier at all	17 (15.9%)
5. Not answered or answer N/A	17 (15.9%)

G. The complicated and lengthy qualification process required for TIF. _____

1: A serious barrier	40 (37.4%)
2: A slight barrier	34 (31.8%)
3: Not a serious barrier	10 (9.3%)
4: Not a barrier at all	5 (4.7%)
5. Not answered or answer N/A	18 (16.8%)

H. The limit on the amount of the project that can be devoted to retail (20 percent if the project is outside of a central business district) _____

1: A serious barrier	21 (19.6%)
2: A slight barrier	37 (34.6%)
3: Not a serious barrier	20 (18.7%)
4: Not a barrier at all	11 (10.3%)
5. Not answered or answer N/A	18 (16.8%)

I. Working with other governments that must be involved _____

1: A serious barrier	12 (11.2%)
2: A slight barrier	30 (28.0%)
3: Not a serious barrier	31 (29.0%)
4: Not a barrier at all	15 (14.0%)
5. Not answered or answer N/A	19 (17.8%)

19. What alternatives to TIF does your jurisdiction currently utilize for economic development or redevelopment projects? Please rate each item according to the following scale:

A. Local revenues -- general fund _____

1: Utilized frequently	39 (36.4%)
2: Utilized occasionally	32 (29.9%)
3: Seldom utilized	11 (10.3%)
4: Not utilized at all	6 (5.6%)
5. Not answered or answer N/A	19 (17.8%)

B. Local revenues -- other than general fund _____

1: Utilized frequently	23 (21.5%)
2: Utilized occasionally	29 (27.1%)
3: Seldom utilized	23 (21.5%)
4: Not utilized at all	13 (12.1%)
5. Not answered or answer N/A	19 (17.8%)

C. Federal/state grants-in-aid _____

1: Utilized frequently	27 (25.2%)
2: Utilized occasionally	48 (44.9%)
3: Seldom utilized	8 (7.5%)
4: Not utilized at all	6 (5.6%)
5. Not answered or answer N/A	18 (16.8%)

D. General obligation bonds _____

1: Utilized frequently	10 (9.3%)
2: Utilized occasionally	17 (15.9%)
3: Seldom utilized	28 (26.2%)
4: Not utilized at all	34 (31.8%)
5. Not answered or answer N/A	18 (16.8%)

E. Revenue bonds _____

1: Utilized frequently	7 (6.5%)
2: Utilized occasionally	16 (15.0%)
3: Seldom utilized	23 (21.5%)
4: Not utilized at all	43 (40.2%)
5. Not answered or answer N/A	18 (16.8%)

F. Special assessment districts _____

1: Utilized frequently	4 (3.7%)
2: Utilized occasionally	8 (7.5%)
3: Seldom utilized	16 (15.0%)
4: Not utilized at all	59 (55.1%)
5. Not answered or answer N/A	20 (18.7%)

G. Hotel/motel taxes _____

1: Utilized frequently	19 (17.8%)
2: Utilized occasionally	14 (13.1%)
3: Seldom utilized	11 (10.3%)
4: Not utilized at all	44 (41.1%)
5. Not answered or answer N/A	19 (17.8%)

H. Sales tax _____

1: Utilized frequently	17 (15.9%)
2: Utilized occasionally	18 (16.8%)
3: Seldom utilized	15 (14.0%)
4: Not utilized at all	38 (35.5%)
5. Not answered or answer N/A	19 (17.8%)

I. Public/private partnerships _____

1: Utilized frequently	19 (17.8%)
2: Utilized occasionally	37 (34.6%)
3: Seldom utilized	13 (12.1%)
4: Not utilized at all	19 (17.8%)
5. Not answered or answer N/A	19 (17.8%)

J. Installment or lease purchase contracts _____

1: Utilized frequently	23 (21.5%)
2: Utilized occasionally	24 (22.4%)
3: Seldom utilized	18 (16.8%)
4: Not utilized at all	24 (22.4%)
5. Not answered or answer N/A	18 (16.8%)

20. Which of the above alternatives (A through H) will most likely be used less if TIF is utilized?

A. Local revenues -- general fund	38 (35.5%)
B. Local revenues -- other than general fund	10 (9.3%)
C. Federal/state grants-in-aid	4 (3.7%)
D. General obligation bonds	8 (7.5%)
E. Revenue bonds	6 (5.6%)
F. Special assessment districts	2 (1.9%)
G. Hotel/motel taxes	3 (2.8%)
H. Sales tax	1 (0.9%)
I. Public/private partnerships	5 (4.7%)
J. Installment or lease purchase contracts	10 (9.3%)

Appendix C

Session Law 2003-403/Senate Bill 725 may also be found on the state website as follows: http://www.ncleg.net/Sessions/2003/Bills/Senate/HTML/S725v6.html

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

SESSION LAW 2003-403
SENATE BILL 725

AN ACT TO AMEND THE NORTH CAROLINA CONSTITUTION TO PERMIT CITIES AND COUNTIES TO INCUR OBLIGATIONS TO FINANCE THE PUBLIC PORTION OF CERTAIN ECONOMIC DEVELOPMENT PROJECTS.

Whereas, the State of North Carolina and local governments in North Carolina are and should be actively engaged in economic development efforts to attract and stimulate private sector job creation and capital investors in their areas; and

Whereas, over 48 other states and local governments in other states are authorized to utilize a wide variety of incentives, including, but not limited to, project development financing to attract private sector economic development; and

Whereas, other states and local governments in other states have been successful in attracting private sector job creation and capital investment to their areas through incentive packages which have included the provision of infrastructure improvements financed through the issuance of project development debt instruments; and

Whereas, economically distressed areas of North Carolina could utilize project development debt instruments to attract new industry to their areas; and

Whereas, project development financing could enable North Carolina to be more nationally or internationally competitive in attracting private sector job creation and capital investments, particularly in attracting major economic development efforts; Now, therefore,

The General Assembly of North Carolina enacts:

SECTION 1. Article V of the North Carolina Constitution is amended by adding a new section to read:

"**Sec. 14. Project development financing.**

Notwithstanding Section 4 of this Article, the General Assembly may enact general laws authorizing any county, city, or town to define territorial areas in the county, city, or town and borrow money to be used to finance public improvements associated with private development projects within the territorial areas, as provided in this section. The General Assembly shall set forth by statute the method for determining the size of the territorial area and the issuing unit. This method is conclusive. When a territorial area is defined pursuant to this section, the county shall determine the current assessed value of taxable real and personal

property in the territorial area. Thereafter, property in the territorial area continues to be subject to taxation to the same extent and in like manner as property not in the territorial area, but the net proceeds of taxes levied on the excess, if any, of the assessed value of taxable real and personal property in the territorial area at the time the taxes are levied over the assessed value of taxable real and personal property in the territorial area at the time the territorial area was defined may be set aside. The instruments of indebtedness authorized by this section shall be secured by these set-aside proceeds. The General Assembly may authorize a county, city, or town issuing these instruments of indebtedness to pledge, as additional security, revenues available to the issuing unit from sources other than the issuing unit's exercise of its taxing power. As long as no revenues are pledged other than the set-aside proceeds authorized by this section and the revenues authorized in the preceding sentence, these instruments of indebtedness may be issued without approval by referendum. The county, city, or town may not pledge as security for these instruments of indebtedness any property tax revenues other than the set-aside proceeds authorized in this section, or in any other manner pledge its full faith and credit as security for these instruments of indebtedness unless a vote of the people is held as required by and in compliance with the requirements of Section 4 of this Article.

Notwithstanding the provisions of Section 2 of this Article, the General Assembly may enact general laws authorizing a county, city, or town that has defined a territorial area pursuant to this section to assess property within the territorial area at a minimum value if agreed to by the owner of the property, which agreed minimum value shall be binding on the current owner and any future owners as long as the defined territorial area is in effect."

SECTION 2. Article 6 of Chapter 159 of the General Statutes is reenacted and is rewritten to read:

"Article 6.

"Project Development Financing Act.

"**§ 159-101. Short title.**

This Article may be cited as the 'North Carolina Project Development Financing Act.'

"**§ 159-102. Unit of local government defined.**

For the purposes of this Article, the term 'unit of local government' means a county or a municipal corporation.

"**§ 159-103. Authorization of project development financing debt instruments; purposes.**

(a) Each unit of local government may issue project development financing debt instruments pursuant to this Article and use the proceeds for one or more of the purposes for which the unit may issue general obligation bonds pursuant to the following subdivisions of G.S. 159-48: (b)(1), (3), (7), (11), (12), (16), (17), (19), (21), (23), (24), or (25), (c)(4a) or (6), or (d)(3), (4), (5), (6), or (7). In addition, the proceeds may be used for any service or facility authorized by G.S. 160A-536 and provided in a municipal service district.

For the purpose of this Article, the term 'capital costs' as defined in G.S. 159-48(h) also includes (i) interest on the debt instruments being issued or on notes issued in anticipation of the instruments during construction and for a period not exceeding seven years after the estimated date of completion of construction and (ii) the establishment of debt service reserves and any other reserves reasonably required by the financing documents. The proceeds of the debt instruments may be used either in a development financing district established pursuant to G.S. 160A-515.1 or G.S. 158-7.3 or, if the use directly benefits private development forecast by the development financing plan for the district, outside the development financing district. The proceeds may be used only for projects

that enable, facilitate, or benefit private development within the development financing district, the revenue increment of which is pledged as security for the debt instruments. This subsection does not prohibit the use of proceeds to defray the cost of providing water and sewer utilities to a private development in a project development financing district.

(b) Subject to agreement with the holders of its project development financing debt instruments and the limitation on duration of development financing districts set out in this Article, each unit of local government may issue additional project development financing debt instruments and may issue debt instruments to refund any outstanding project development financing debt instruments at any time before the final maturity of the instruments to be refunded. General obligation bonds issued to refund outstanding project development financing debt instruments shall be issued under the Local Government Bond Act, Article 4 of this Chapter. Revenue bonds issued to refund outstanding project development financing debt instruments shall be issued under the State and Local Government Revenue Bond Act, Article 5 of this Chapter.

Project development financing debt instruments may be issued partly for the purpose of refunding outstanding project development financing debt instruments and partly for any other purpose under this Article. Project development financing debt instruments issued to refund outstanding project development financing debt instruments shall be issued under this Article and not under Article 4 of this Chapter.

(c) If the private development project to be benefited by proposed project development financing debt instruments affects tax revenues in more than one unit of local government and more than one affected unit of local government wishes to provide assistance to the private development project by issuing project development financing debt instruments, then those units may enter into an interlocal agreement pursuant to Article 20 of Chapter 160A of the General Statutes for the purpose of issuing the instruments. The agreement may include a provision that a unit may pledge all or any part of the taxes received or to be received on the incremental valuation accruing to the development financing district to the repayment of instruments issued by another unit that is a party to the interlocal agreement.

"**§ 159-104. Application to Commission for approval of project development financing debt instrument issue; preliminary conference; acceptance of application.**

A unit of local government may not issue project development financing debt instruments under this Article unless the issue is approved by the Local Government Commission. The governing body of the issuing unit shall file with the secretary of the Commission an application for Commission approval of the issue. At the time of application, the governing body shall publish a public notice of the application in a newspaper of general circulation in the unit of local government. The application shall include any statements of facts and documents concerning the proposed debt instruments, development financing district, and development financing plan, and the financial condition of the unit, required by the secretary. The Commission may prescribe the form of the application.

Before accepting the application, the secretary may require the governing body or its representatives to attend a preliminary conference in order to discuss informally the proposed issue, district, and plan and the timing of the steps to be taken in issuing the debt instruments. The development financing plan need not be adopted by the governing body at the time it files the application with the secretary. However, before the Commission may enter its order approving the debt instruments, the governing body must adopt the plan and make the findings described in G.S. 159-105(b)(1) and (5).

After an application in proper form and order has been filed, and after a preliminary conference if one is required, the secretary shall notify the unit in writing that the application has been filed and accepted for submission to the Commission. The secretary's statement is conclusive evidence that the unit has complied with this section.

"**§ 159-105. Approval of application by Commission.**

(a) In determining whether to approve a proposed project development financing debt instrument issue, the Commission may inquire into and consider any matters that it considers relevant to whether the issue should be approved, including:

(1) Whether the projects to be financed from the proceeds of the project development financing debt instrument issue are necessary to secure significant new project development for a development financing district.

(2) Whether the proposed projects are feasible. In making this determination, the Commission may consider any additional security such as credit enhancement, insurance, or guaranties.

(3) The unit of local government's debt management procedures and policies.

(4) Whether the unit is in default in any of its debt service obligations.

(5) Whether the private development forecast in the development financing plan would likely occur without the public project or projects to be financed by the project development financing debt instruments.

(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) The ability of the Commission to market the proposed project development financing debt instruments at reasonable rates of interest.

(b) The Commission shall approve the application if, upon the information and evidence it receives, it finds all of the following:

(1) The proposed project development financing debt instrument issue is necessary to secure significant new economic development for a development financing district.

(2) The amount of the proposed project development financing debt is adequate and not excessive for the proposed purpose of the issue.

(3) The proposed projects are feasible. In making this determination, the Commission may consider any additional security such as credit enhancement, insurance, or guaranties.

(4) The unit of local government's debt management procedures and policies are good, or that reasonable assurances have been given that its debt will henceforth be managed in strict compliance with law.

(5) The private development forecast in the development financing plan would not be likely to occur without the public projects to be financed by the project development financing debt instruments.

(6) The proposed project development financing debt instruments can be marketed at reasonable interest cost to the issuing unit.

(7) The issuing unit has, pursuant to G.S. 160A-515.1 or G.S. 158-7.3, adopted a development financing plan for the development financing district for which the instruments are to be issued.

"**§ 159-106. Order approving or denying the application.**

(a) After considering an application, the Commission shall enter its order either approving or denying the application. An order approving an issue is not an approval of the legality of the debt instruments in any respect.

(b) Unless the debt instruments are to be issued for a development financing district for which a project development financing debt instrument issue has already been approved, the day the Commission enters its order approving an application for project development financing debt instruments is also the effective date of the development financing district for which the instruments are to be issued.

(c) If the Commission enters an order denying the application, the proceedings under this Article are at an end.

"**§ 159-107. Determination of incremental valuation; use of taxes levied on incremental valuation; duration of the district.**

(a) Base Valuation in the Development Financing District. – After the Local Government Commission has entered its order approving a unit of local government's application for project development financing debt instruments, the unit shall immediately notify the tax assessor of the county in which the development financing district is located of the existence of the development financing district. Upon receiving this notice, the tax assessor shall determine the base valuation of the district, which is the assessed value of all taxable property located in the district on the January 1 immediately preceding the effective date of the district. If the unit or an agency of the unit acquired property within the district within one year before the effective date of the district, the tax assessor shall presume, subject to rebuttal, that the property was acquired in contemplation of the district, and the tax assessor shall include the value of the property so acquired in determining the base valuation of the district. The unit may rebut this presumption by showing that the property was acquired primarily for a purpose other than to reduce the incremental tax base. After determining the base valuation of the development financing district, the tax assessor shall certify the valuation to: (i) the issuing unit; (ii) the county in which the district is located if the issuing unit is not the county; and (iii) any special district, as defined in G.S. 159-7, within which the development financing district is located.

(b) Adjustments to the Base Valuation. – During the lifetime of the development financing district, the base valuation shall be adjusted as follows:

(1) If the unit amends its development financing plan, pursuant to G.S. 160A-515.1 or G.S. 158-7.3, to remove property from the development financing district, on the succeeding January 1, that property shall be removed from the district and the base valuation reduced accordingly.

(2) If the unit amends its development financing plan, pursuant to G.S. 160A-515.1 or G.S. 158-7.3, to expand the district, the new property shall be added to the district immediately. The base valuation of the district shall be increased by the assessed value of the taxable property situated in the added territory on the January 1 immediately preceding the effective date of the district.

(3) If, at the time of revaluation pursuant to G.S. 105-286 of property in the county in which the district is located, it appears that, based on the schedule of values, standards, and rules approved by the board of county commissioners pursuant to G.S. 105-317, the

property values of the district as they existed on the January 1 immediately preceding the effective date of the district would be increased because of the revaluation, then the base valuation shall be increased accordingly.

Each time the base valuation is adjusted, the tax assessor shall immediately certify the new base valuation to: (i) the issuing unit; (ii) the county if the issuing unit is not the county; and (iii) any special district, as defined in G.S. 159-7, within which the development financing district is located.

(c) Revenue Increment Fund. – When a unit of local government has established a development financing district, and the project development financing debt instruments for that district have been approved by the Commission, the unit shall establish a separate fund to account for the proceeds paid to the unit from taxes levied on the incremental valuation of the district. The unit shall also place in this fund any moneys received pursuant to an agreement entered into under G.S. 159-108.

(d) Levy of Property Taxes Within the District. – Each year the development financing district is in existence, the tax assessor shall determine the current assessed value of taxable property located in the district. The assessor shall also compute the difference between this current value and the base valuation of the district. If the current value exceeds the base value, the difference is the incremental valuation of the district. In each year the district is in existence, the county, and if the district is within a city or a special district as defined by G.S. 159-7, the city or the special district shall levy taxes against property in the district in the same manner as taxes are levied against other property in the county, city, or special district. The proceeds from ad valorem taxes levied on property in the development financing district shall be distributed as follows:

(1) In any year in which there is no incremental valuation of the district, all the proceeds of the taxes shall be retained by the county, city, or special district, as if there were no development financing district in existence.

(2) In any year in which there is an incremental valuation of the district, the amount of tax due from each taxpayer on property in the district shall be distributed as provided in this subdivision. The net proceeds of the following taxes shall be paid to the government levying the tax: (i) taxes separately stated and levied solely to service and repay debt secured by a pledge of the faith and credit of the unit; (ii) nonschool taxes levied pursuant to a vote of the people; (iii) taxes levied for a municipal or county service district; and (iv) taxes levied by a taxing unit in a development financing district established by a different taxing unit and for which there is no increment agreement between the two units. All remaining taxes on property in the district shall be multiplied by a fraction, the numerator of which is the base valuation for the district and the denominator of which is the current valuation for the district. The amount shown as the product of this multiplication shall, when paid by the taxpayer, be retained by the county, city, or special district, as if there were no development financing district in existence. The net proceeds of the remaining amount shall, when paid by the taxpayer, be turned over to the finance officer of each issuing unit, who shall place this amount in the special revenue increment fund required by subsection (c) of this section. As used in this section, 'net proceeds' means gross proceeds less refunds, releases, and any

collection fee paid by the levying government to the collecting government.

(e) Increment Agreements. – Effect of Annexation on District Established by a County. – If a city annexes land in a development financing district established by a county pursuant to G.S. 158-7.3, the proceeds of all taxes levied by the city on property within the district shall be paid to the city unless the city enters into an agreement with the county pursuant to this subsection. The city and the county may enter into an increment agreement under which the city agrees that city taxes on part or all of the incremental valuation in the district shall be paid into the revenue increment fund for the district. An increment agreement may be entered into when the district is established or at any time after the district is established. The increment agreement may extend for the duration of the district or for a shorter time agreed to by the parties.

(f) Use of Moneys in the Revenue Increment Fund. – If the development financing district includes property conveyed or leased by the unit of local government to a private party in consideration of increased tax revenue expected to be generated by improvements constructed on the property pursuant to G.S. 158-7.1, an amount equal to the tax revenue taken into account in arriving at the consideration, less the increased tax revenue realized since the construction of the improvement, shall be transferred from the Revenue Increment Fund to the county, city, or special district as if there were no development financing district in existence. Any money in excess of this amount in the Fund may be used for any of the following purposes, without priority other than priorities imposed by the order authorizing the project development financing debt instruments:

(1) To finance capital expenditures (including the funding of capital reserves) by the issuing unit in the development financing district pursuant to the development financing plan.

(2) To meet principal and interest requirements on project development financing debt instruments and debt instrument anticipation notes issued for the district.

(3) To repay the appropriate fund of the issuing unit for any moneys actually expended on debt service on project development financing debt instruments pursuant to a pledge made pursuant to G.S. 159-111(b).

(4) To establish and maintain debt service reserves for future principal and interest requirements on project development financing debt instruments and debt instrument anticipation notes issued for the district.

(5) To meet any other requirements imposed by the order authorizing the project development financing debt instruments.

If in any year there is any money remaining in the Revenue Increment Fund after these purposes have been satisfied, it shall be paid to the general fund of the county and, if applicable, of the city and any special district as defined by G.S. 159-7, in proportion to their rates of ad valorem tax on taxable property located in the development financing district.

(g) Duration of District. – A development financing district shall terminate at the earlier of (i) the end of the thirtieth year after the effective date of the district or (ii) the date all project development financing debt instruments issued for the district have been fully retired or sufficient funds have been set aside, pursuant to the order authorizing the debt instruments, to meet all future principal and interest requirements on the instruments.

"**§ 159-108. Agreements with property owners.**

(a) Authorization. – A unit of local government that issues project development financing debt instruments may enter into agreements with the

owners of real property in the development financing district for which the instruments were issued under which the owners agree to a minimum value at which their property will be assessed for taxation. Such an agreement may extend for the life of the development financing district or for a shorter period agreed to by the parties. The agreement may vary the agreed-upon minimum assessed value from year to year.

(b) Filing and Recording Agreement. – The unit shall file a copy of any agreement entered into pursuant to this section with the tax assessor for the county in which the development financing district is located. In addition, the unit shall cause the agreement to be recorded in the office of the register of deeds of that county, and the register of deeds shall index the agreement in the grantor's index under the name of the property owner. Once the agreement has been recorded in the office of the register of deeds, as required by this subsection, it is binding, according to its terms and for its duration, on any subsequent owner of the property.

(c) Minimum Assessment of Property. – An agreement entered into pursuant to this section establishes a minimum assessment of the real property subject to the agreement. If the county tax assessor determines that the real property has a true value less than the minimum established by the agreement, the assessor shall nevertheless assess the property at the minimum set out in the agreement. If the assessor, however, determines that the real property has a true value greater than the minimum established by the agreement, the assessor shall assess the property at the true value.

(d) Effect of Reappraisal. – If an agreement entered into pursuant to this section continues in effect after a reappraisal of property conducted pursuant to G.S. 105-286, the minimum assessment established in the agreement shall be adjusted as provided in this subsection. After the issuing unit of local government has adopted its budget ordinance and levied taxes for the fiscal year that begins next after the effective date of the reappraisal, it shall certify to the county tax assessor the total rate of ad valorem taxes levied by the unit and applicable to the property subject to the agreement. It shall also certify to the assessor the total rate of ad valorem taxes levied by the unit and applicable to the property in the immediately preceding fiscal year. The assessor shall determine the total amount of ad valorem taxes levied by the unit on the property in the immediately preceding fiscal year, based on the tax rate certified by the issuing unit. The assessor shall then determine a value of the property that would provide the same total amount of ad valorem taxes based on the tax rate certified for the fiscal year beginning next after the effective date of the reappraisal. The value so determined is the new minimum assessment for the property subject to the agreement.

(e) Agreement Effective Regardless of Improvements. – An agreement entered into pursuant to this section remains in effect according to its terms regardless of whether the improvements anticipated in the development financing plan are completed or whether those improvements continue to exist during the duration of the agreement. However, if any part of the property subject to the agreement is acquired by a public agency, the agreement is automatically modified by removing the acquired property from the agreement and reducing the minimum assessment accordingly.

"**§ 159-109. Special covenants.**

A project development financing debt instrument order or a trust agreement securing project development financing debt instruments may contain covenants regarding:

(1) The pledge of all or any part of the taxes received or to be received on the incremental valuation in the development financing district during the life of the debt instruments.

(2) Rates, fees, rentals, tolls, or other charges to be established, maintained, and collected, and the use and disposal of revenues, gifts, grants, and funds received or to be received.
(3) The setting aside of debt service reserves and the regulation and disposition of these reserves.
(4) The custody, collection, securing, investment, and payment of any moneys held for the payment of project development financing debt instruments.
(5) Limitations or restrictions on the purposes to which the proceeds of sale of project development financing debt instruments may be applied.
(6) Limitations or restrictions on the issuance of additional project development financing debt instruments or notes for the same development financing district, the terms upon which additional project development financing debt instruments or notes may be issued or secured, or the refunding of outstanding project development financing debt instruments or notes.
(7) The acquisition and disposal of property for project development financing debt instrument projects.
(8) Provision for insurance and for accounting reports, and the inspection and audit of accounting reports.
(9) The continuing operation and maintenance of projects financed with the proceeds of the project development financing debt instruments.

"**§ 159-110. Security of project development financing debt instruments.**

Project development financing debt instruments are special obligations of the issuing unit. Moneys in the Revenue Increment Fund required by G.S. 159-107(c) are pledged to the payment of the instruments, in accordance with G.S. 159-107(f). Except as provided in G.S. 159-111, the unit may pledge the following additional sources of funds to the payment of the debt instruments, and no other sources: the proceeds from the sale of property in the development financing district; net revenues from any public facilities, other than portions of public utility systems, in the development financing district financed with the proceeds of the project development financing debt instruments; and, subject to G.S. 159-47, net revenues from any other public facilities, other than portions of public utility systems, in the development financing district constructed or improved pursuant to the development financing plan.

Except as provided in G.S. 159-111, the principal and interest on project development financing debt instruments do not constitute a legal or equitable pledge, charge, lien, or encumbrance upon any of the unit's property or upon any of its income, receipts, or revenues, except as may be provided pursuant to this section. Except as provided in G.S. 159-107 and G.S. 159-111, neither the credit nor the taxing power of the unit is pledged for the payment of the principal or interest of project development financing debt instruments, and no holder of project development financing debt instruments has the right to compel the exercise of the taxing power by the unit or the forfeiture of any of its property in connection with any default on the instruments. Unless the unit's taxing power has been pledged pursuant to G.S. 159-111, every project development financing debt instrument shall contain recitals sufficient to show the limited nature of the security for the instrument's payment and that it is not secured by the full faith and credit of the unit.

"**§ 159-111. Additional security for project development financing debt instruments.**

(a) In order to provide additional security for debt instruments issued pursuant to this Article, the issuing unit of local government may pledge its faith and credit for the payment of the principal of and interest on the debt instruments. Before such a pledge may be given, the unit shall follow the procedures and meet the requirements for approval of general obligation bonds under Article 4 of this Chapter. The unit shall also follow the procedures and meet the requirements of this Article. If debt instruments are issued pursuant to this Article and are also secured by a pledge of the issuing unit's faith and credit, the debt instruments are subject to G.S. 159-112 rather than G.S. 159-65.

(b) In order to provide additional security for debt instruments issued pursuant to this Article, and in lieu of pledging its faith and credit for that purpose pursuant to subsection (a) of this section, a unit of local government may agree to apply to the payment of the instruments any available sources of revenues of the unit, as long as the agreement to use the sources to make payment does not constitute a pledge of the unit's taxing power or of the unit's revenues derived from local sales taxes. In addition, to the extent the generation of the revenues is within the power of the unit, the unit may enter into covenants to take action in order to generate the revenues, as long as the covenant does not constitute a pledge of the unit's taxing power.

(c) No agreement or covenant may contain a nonsubstitution clause that restricts the right of the issuing unit of local government to replace or provide a substitute for any project financed pursuant to this subsection.

(d) The obligation of a unit of local government with respect to the sources of payment shall be specifically identified in the proceedings of the governing body authorizing the unit to issue the debt instruments. The sources of payment so specifically identified and then held or thereafter received by the unit or any fiduciary of the unit are immediately subject to the lien of the proceedings without any physical delivery of the sources or further act. The lien is valid and binding as against all parties having claims of any kind against a unit without regard to whether the parties have notice of the lien. The proceedings or any other document or action by which the lien on a source of payment is created need not be filed or recorded in any manner other than as provided in this Article.

"**§ 159-112. Limitations on details of debt instruments.**

In fixing the details of project development financing debt instruments, the governing body of the issuing unit of local government is subject to these restrictions and directions:

(1) The maturity date shall not exceed the shorter of (i) the longest of the various maximum periods of usefulness for the projects to be financed with debt instrument proceeds, as prescribed by the Local Government Commission pursuant to G.S. 159-122, or (ii) the end of the thirtieth year after the effective date of the development financing district.

(2) The first payment of principal shall be payable not more than seven years after the date of the debt instruments.

(3) Any debt instrument may be made payable on demand or tender for purchase as provided in G.S. 159-79, and any debt instrument may be made subject to redemption prior to maturity, with or without premium, on such notice, at such times, and with such redemption provisions as may be stated. Interest on the debt instruments shall cease when the instruments have been validly called for redemption and provision has been made for the payment of the principal of the instruments, any redemption, any premium, and the interest on the instruments accrued to the date of redemption.

(4) The debt instruments may bear interest at such rates payable semiannually or otherwise, may be in such denominations, and may be payable in such kind of money and in such place or places within or without this State as the issuing unit may determine.

"**§ 159-113. Annual report.**

In July of each year, each unit of local government with outstanding project development financing debt instruments shall make a report to any other unit, and to any special district as defined in G.S. 159-7, in which the development financing district for which the instruments were issued is located. This report shall set out the base valuation for the development financing district, the current valuation for the district, the amount of remaining project development financing debt for the district, and the unit's estimate of when the debt will be retired. The unit of local government may meet this requirement by reporting this information in its annual financial statements required by G.S. 159-34."

SECTION 3. G.S. 159-48(b) is amended by adding a new subdivision to read:

"(26) Undertaking public activities in or for the benefit of a development financing district pursuant to a development financing plan."

SECTION 4. G.S. 159-55(a) reads as rewritten:

"(a) After the bond order has been introduced and before the public hearing thereon, the finance officer (or some other officer designated by the governing board for this purpose) shall file with the clerk a statement showing the following:

(1) The gross debt of the unit, excluding therefrom debt incurred or to be incurred in anticipation of the collection of taxes or other revenues or in anticipation of the sale of bonds other than funding and refunding bonds. The gross debt (after exclusions) is the sum of (i) outstanding debt evidenced by bonds, (ii) bonds authorized by orders introduced but not yet adopted, (iii) unissued bonds authorized by adopted orders, and (iv) outstanding debt not evidenced by bonds. However, for purposes of the sworn statement of debt and the debt limitation, revenue bonds and project development financing debt instruments (unless additionally secured by a pledge of the issuing unit's faith and credit) shall not be considered debt and ~~such bonds~~ shall not be included in gross debt nor deducted from gross debt.

(2) The deductions to be made from gross debt in computing net debt. The following deductions are allowed:

a. Funding and refunding bonds authorized by orders introduced but not yet adopted.

b. Funding and refunding bonds authorized but not yet issued.

c. The amount of money held in sinking funds or otherwise for the payment of any part of the principal of gross debt other than debt incurred for water, gas, electric light or power purposes, or sanitary sewer purposes (to the extent that the bonds are deductible under subsection (b) of this section), or two or more of these purposes.

d. The amount of bonded debt included in gross debt and incurred, or to be incurred, for water, gas, or electric light or power purposes, or any two or more of these purposes.

e. The amount of bonded debt included in the gross debt and incurred, or to be incurred, for sanitary sewer system

purposes to the extent that the debt is made deductible by subsection (b) of this section.

f. The amount of uncollected special assessments theretofore levied for local improvements for which any part of the gross debt (that is not otherwise deducted) was or is to be incurred, to the extent that the assessments will be applied, when collected, to the payment of any part of the gross debt.

g. The amount, as estimated by the governing board of the issuing unit or an officer designated by the board for this purpose, of special assessments to be levied for local improvements for which any part of the gross debt (that is not otherwise deducted) was or is to be incurred, to the extent that the special assessments, when collected, will be applied to the payment of any part of the gross debt.

(3) The net debt of the issuing unit, being the difference between the gross debt and deductions.

(4) The assessed value of property subject to taxation by the issuing unit, as revealed by the tax records and certified to the issuing unit by the assessor. In calculating the assessed value, the incremental valuation of any development financing district located in the unit, as determined pursuant to G.S. 159-107, shall not be included.

(5) The percentage that the net debt bears to the assessed value of property subject to taxation by the issuing unit."

SECTION 5. G.S. 159-79(a) reads as rewritten:

"(a) Notwithstanding any provisions of this Chapter to the contrary, including particularly, but without limitation, the provisions of G.S. 159-65, G.S. 159-112, G.S. 159-123 to G.S. 159-127, inclusive, G.S. 159-130, G.S. 159-138, G.S. 159-162, G.S. 159-164 and G.S. 159-172, a unit of local government, in fixing the details of general obligation bonds to be issued pursuant to this ~~Article or~~Article, general obligation notes to be issued pursuant to Article 9 of this Chapter, or project development financing debt instruments or notes to be issued pursuant to Article 6 of this Chapter, may provide that ~~such bonds or notes~~the instruments or notes:

(1) May be made payable from time to time on demand or tender for purchase by the owner provided a Credit Facility supports such bonds or notes, unless the Commission specifically determines that a Credit Facility is not required upon a finding and determination by the Commission that the proposed bonds or notes will satisfy the conditions set forth in G.S. 159-52;

(2) May be additionally supported by a Credit Facility;

(3) May be made subject to redemption prior to maturity, with or without premium, on such notice, at such time or times, at such price or prices and with such other redemption provisions as may be stated in the resolution fixing the details of such bonds or notes or with such variations as may be permitted in connection with a Par Formula provided in such resolution;

(4) May bear interest at a rate or rates that may vary as permitted pursuant to a Par Formula and for such period or periods of time, all as may be provided in such resolution; and

(5) May be made the subject of a remarketing agreement whereby an attempt is made to remarket the bonds to new purchases prior to

their presentment for payment to the provider of the Credit Facility or to the issuing unit."

SECTION 6. G.S. 159-120 reads as rewritten:

"**§ 159-120. Definitions.**

As used in this Article, unless the context clearly requires another meaning, the words 'unit' or 'issuing unit' mean 'unit of local government' as defined in ~~G.S. 159-44,~~ G.S. 159-44 or G.S. 159-102, 'municipality' as defined in G.S. 159-81, and the State of North Carolina, and the words 'governing body,' when used with respect to the State of North Carolina, mean the Council of State."

SECTION 7. G.S. 159-122(a) reads as rewritten:

"(a) Except as provided in this subsection, the last installment of each bond issue shall mature not later than the date of expiration of the period of usefulness of the capital project to be financed by the bond issue, computed from the date of the bonds. The last installment of a refunding bond issue issued pursuant to G.S. 159-48(a)(4) or (5) shall mature not later than either (i) the shortest period, but not more than 40 years, in which the debt to be refunded can be finally paid without making it unduly burdensome on the taxpayers of the issuing unit, as determined by the Commission, computed from the date of the bonds, or (ii) the end of the unexpired period of usefulness of the capital project financed by the debt to be refunded. The last installment of bonds issued pursuant to G.S. 159-48(a)(1), (2), (3), (6), or (7) shall mature not later than 10 years after the date of the bonds, as determined by the Commission. The last installment of bonds issued pursuant to G.S. 159-48(c)(5) shall mature not later than eight years after the date of the bonds, as determined by the Commission. The last installment of project development financing debt instruments shall mature on the earlier of 30 years after the effective date of the development financing district for which the instruments are issued or the longest of the various maximum periods of usefulness for the projects to be financed with debt instrument proceeds, as prescribed by the Commission pursuant to this section."

SECTION 8. G.S. 159-123(b) reads as rewritten:

"(b) The following classes of bonds may be sold at private sale:

(1) Bonds that a State or federal agency has previously agreed to purchase.

(2) Any bonds for which no legal bid is received within the time allowed for submission of bids.

(3) Revenue bonds, including any refunding bonds issued pursuant to G.S. 159-84, and special obligation bonds issued pursuant to Chapter 159I of the General Statutes.

(4) Refunding bonds issued pursuant to G.S. 159-78.

(5) Refunding bonds issued pursuant to G.S. 159-72 if the Local Government Commission determines that a private sale is in the best interest of the issuing unit.

(6) Bonds designated as qualified zone academy bonds pursuant to G.S. 115C-489.6, if the Local Government Commission determines that a private sale is in the best interest of the issuing unit.

(7) Project development financing debt instruments."

SECTION 9. G.S. 159-125(a) reads as rewritten:

"(a) Except for revenue ~~bonds,~~ bonds and project development financing debt instruments, no bid for less than ninety-eight percent (98%) of the face value of the bonds plus one hundred percent (100%) of accrued interest may be entertained.

Different rates of interest may be bid for bonds maturing in different years, but different rates of interest may not be bid for bonds maturing in the same year."

SECTION 10. G.S. 159-129 reads as rewritten:

"**§ 159-129. Obligations of units certified by Commission.**

Each bond or bond anticipation note that is represented by an instrument shall bear on its face or reverse a certificate signed by the secretary of the Commission or an assistant designated by ~~him~~ the secretary that the issuance of the bond or note has been approved under the provisions of The Local Government Bond ~~Act of~~ Acts, the Local Government Revenue Bond ~~Act.~~ Act, or the North Carolina Project Development Financing Act. ~~Such~~ This signature may be a manual or facsimile signature as the Commission may determine. Each bond or bond anticipation note that is not represented by an instrument shall be evidenced by a writing relating to such obligation, which writing shall identify such obligation or the issue of which it is part, bear ~~such certificate~~ this certificate, and be on file with the Commission. The certificate shall be conclusive evidence that the requirements of this Subchapter have been observed, and no bond or note without the Commission's certificate or with respect to which a writing bearing ~~such~~ this certificate has not been filed with the Commission shall be valid."

SECTION 11. G.S. 159-132 reads as rewritten:

"**§ 159-132. State Treasurer to deliver bonds and remit proceeds.**

When the bonds are executed, they shall be delivered to the State Treasurer who shall deliver them to the order of the purchaser and collect the purchase price or proceeds. The Treasurer shall then pay from the proceeds any notes issued in anticipation of the sale of the bonds, deduct from the proceeds the Commission's expense in connection with the issue, and remit the net proceeds to the official depository of the unit after assurance that the deposit will be adequately secured as required by law. The proceeds of funding or refunding bonds may be deposited at the place of payment of the indebtedness to be refunded or funded for use solely in the payment of such indebtedness. The proceeds of revenue bonds shall be remitted to the trustee or other depository specified in the trust agreement or resolution securing them. Unless otherwise provided in the trust agreement or resolution securing the debt instruments, the proceeds of project development financing debt instruments shall be remitted in the manner provided by this section for the remission of the proceeds of general obligation bonds."

SECTION 12. G.S. 159-160 reads as rewritten:

"**§ 159-160. Definitions.**

As used in this Part, the words 'unit' or 'issuing unit' means 'unit of local government' as defined in G.S. ~~159-44,~~ 159-44 or G.S. 159-102, 'municipality' as defined in G.S. 159-81, and the State of North Carolina."

SECTION 13. G.S. 159-163.1 is reenacted and is rewritten to read:

"**§ 159-163.1. Security of project development financing debt instrument anticipation notes.**

Notes issued in anticipation of the sale of project development financing debt instruments are special obligations of the issuing unit. Except as provided in G.S. 159-107 and G.S. 159-110, neither the credit nor the taxing power of the issuing unit may be pledged for the payment of notes issued in anticipation of the sale of project development financing debt instruments. No holder of a project development financing debt instrument anticipation note has the right to compel the exercise of the taxing power by the issuing unit or the forfeiture of any of its property in connection with any default on the note. Notes issued in anticipation of the sale of project development financing debt instruments may be secured by the same pledges, charges, liens, covenants, and agreements made to secure the project development financing debt instruments. In addition, the proceeds of each project development financing debt instrument issue are pledged for the payment of any notes issued in anticipation of the sale of the instruments, and these notes shall be retired from the proceeds of the sale as the first priority."

SECTION 14. G.S. 159-165(b) reads as rewritten:

"(b) When the bond anticipation notes are executed, they shall be delivered to the State Treasurer who shall deliver them to the order of the purchaser and collect the purchase price or proceeds. The Treasurer shall then deduct from the proceeds the Commission's expense in connection with the issue, and remit the net proceeds to the official depository of the unit after assurance that the deposit will be adequately secured as required by law. The net proceeds of revenue bond anticipation ~~notes or~~ notes, special obligation bond anticipation ~~notes~~ notes, or project development financing debt instrument anticipation notes shall be remitted to the trustee or other depository specified in the trust agreement or resolution securing them. If the notes have been issued to renew outstanding notes, the Treasurer, in lieu of collecting the purchase price or proceeds, may provide for the exchange of the newly issued notes for the notes to be renewed."

SECTION 15. G.S. 159-176 reads as rewritten:

"**§ 159-176. Commission to aid defaulting units in developing refinancing plans.**

If a unit of local government or municipality ~~(as defined in G.S. 159-44 or 159-81)~~ (as defined in G.S. 159-44, 159-81, or 159-102) fails to pay any installment of principal or interest on its outstanding debt on or before the due date (whether the debt is evidenced by general obligation bonds, revenue bonds, project development financing debt instruments, bond anticipation notes, tax anticipation notes, or revenue anticipation notes) and remains in default for 90 days, the Commission may take such action as it deems advisable to investigate the unit's or municipality's fiscal affairs, consult with its governing board, and negotiate with its creditors in order to assist the unit or municipality in working out a plan for refinancing, adjusting, or compromising the debt. When a plan is developed that the Commission finds to be fair and equitable and reasonably within the ability of the unit or municipality to meet, the Commission shall enter an order finding that it is fair, equitable, and within the ability of the unit or municipality to meet. The Commission shall then advise the governing board to take the necessary steps to implement it. If the governing board declines or refuses to do so within 90 days after receiving the Commission's advice, the Commission may enter an order directing the governing board to implement the plan. When this order is entered, the members of the governing board and all officers and employees of the unit or municipality shall be under an affirmative duty to do all things necessary to implement the plan. The Commission may apply to the appropriate division of the General Court of Justice for a court order to the governing board and other officers and employees of the unit or municipality to enforce the Commission's order."

SECTION 16. G.S. 160A-505(a) reads as rewritten:

"(a) In lieu of creating a redevelopment commission as authorized herein, the governing body of any municipality may, if it deems wise, either designate a housing authority created under the provisions of Chapter 157 of the General Statutes to exercise the powers, duties, and responsibilities of a redevelopment commission as prescribed herein, or undertake to exercise such powers, duties, and responsibilities itself. Any such designation shall be by passage of a resolution adopted in accordance with the procedure and pursuant to the findings specified in G.S. 160A-504(a) and (b). In the event a governing body designates itself to perform the powers, duties, and responsibilities of a redevelopment ~~commission,~~ commission under this subsection, or exercises those powers, duties, and responsibilities pursuant to G.S. 153A-376 or G.S. 160A-456, then where any act or proceeding is required to be done, recommended, or approved both by a redevelopment commission and by the municipal governing body, then the performance, recommendation, or approval thereof once by the municipal governing body shall be sufficient to make such performance, recommendation, or

approval valid and legal. In the event a municipal governing body designates itself to exercise the powers, duties, and responsibilities of a redevelopment commission, it may assign the administration of redevelopment policies, programs and plans to any existing or new department of the municipality."

SECTION 17. G.S. 160A-512(6) reads as rewritten:

"(6) Within its area of operation, to purchase, obtain options upon, acquire by gift, grant, bequest, devise, eminent domain or otherwise, any real or personal property or any interest therein, together with any improvements thereon, necessary or incidental to a redevelopment project; to hold, improve, clear or prepare for redevelopment any such property, and ~~notwithstanding the provisions of G.S. 160-59 but~~ subject to the provisions of G.S. 160A-514, and with the approval of the local governing body sell, exchange, transfer, assign, subdivide, retain for its own use, mortgage, pledge, hypothecate or otherwise encumber or dispose of any real or personal property or any interest therein, either as an entirety to a single 'redeveloper' or in parts to several redevelopers; provided that the commission finds that the sale or other transfer of any such part will not be prejudicial to the sale of other parts of the redevelopment area, nor in any other way prejudicial to the realization of the redevelopment plan approved by the governing body; to enter into ~~contracts~~ contracts, either before or after the real property that is the subject of the contract is acquired by the Commission (although disposition of the property is still subject to G.S. 160A-514), with 'redevelopers' of property containing covenants, restrictions, and conditions regarding the use of such property for residential, commercial, industrial, recreational purposes or for public purposes in accordance with the redevelopment plan and such other covenants, restrictions and conditions as the commission may deem necessary to prevent a recurrence of blighted areas or to effectuate the purposes of this Article; to make any of the covenants, restrictions or conditions of the foregoing contracts covenants running with the land, and to provide appropriate remedies for any breach of any such covenants or conditions, including the right to terminate such contracts and any interest in the property created pursuant thereto; to borrow money and issue bonds therefor and provide security for bonds; to insure or provide for the insurance of any real or personal property or operations of the commission against any risks or hazards, including the power to pay premiums on any such insurance; and to enter into any contracts necessary to effectuate the purposes of this Article;".

SECTION 18. G.S. 160A-515.1 is reenacted and is rewritten to read:

"**§ 160A-515.1. Project development financing.**

(a) Authorization. – A city may finance a redevelopment project and any related public improvements with the proceeds of project development financing debt instruments, issued pursuant to Article 6 of Chapter 159 of the General Statutes, together with any other revenues that are available to the city. Before it receives the approval of the Local Government Commission for issuance of project development financing debt instruments, the city's governing body must define a development financing district and adopt a development financing plan for the district. The city may act jointly with a county to finance a project, define a

development financing district, and adopt a development financing plan for the district.

(b) Development Financing District. – A development financing district shall comprise all or portions of one or more redevelopment areas defined pursuant to this Article. The total land area within development financing districts in a city, including development financing districts created pursuant to G.S. 158-7.3, may not exceed five percent (5%) of the total land area of the city.

(c) Development Financing Plan. – The development financing plan must be compatible with the redevelopment plan or plans for the redevelopment area or areas included within the district. The development financing plan must include all of the following:

(1) A description of the boundaries of the development financing district.
(2) A description of the proposed development of the district, 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.
(5) The base valuation of the development financing district.
(6) The projected incremental valuation of the development financing district.
(7) The estimated duration of the development financing district.
(8) A description of how the proposed development of the district, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, or services.
(9) A description of the appropriate ameliorative activities which will be undertaken if the proposed projects have a negative impact on residents or business owners of the district in terms of jobs, affordable housing, services, or displacement.
(10) A requirement that the initial users of any new manufacturing facilities that will be located in the district and that are included in the plan will comply with the wage requirements in subsection (d) of this section.

(d) Wage Requirements. – A development financing plan shall include a requirement that the initial users of a new manufacturing facility to be located in the district and included in the plan must pay its employees an average weekly manufacturing wage that is either above the average manufacturing wage paid in the county in which the district will be located or not less than ten percent (10%) above the average weekly manufacturing wage paid in the State. The plan may include information on the wages to be paid by the initial users of a new manufacturing facility to its employees and any provisions necessary to implement the wage requirement. The issuing unit's governing body shall not adopt a plan until the Secretary of Commerce certifies that the Secretary has reviewed the average weekly manufacturing wage required by the plan to be paid to the employees of a new manufacturing facility and has found either (i) that the wages proposed by the initial users of a new manufacturing facility are in compliance with the amount required by this subsection or (ii) that the plan is exempt from the requirement of this subsection. The Secretary of Commerce may exempt a plan from the requirement of this subsection if the Secretary receives a resolution from the issuing unit's governing body requesting an exemption from the wage requirement and a letter from an appropriate State official, selected by the Secretary, finding that unemployment in the county in which the proposed district is to be located is especially severe. Upon the creation of the district, the unit of

local government proposing the creation of the district shall take any lawful actions necessary to require compliance with the applicable wage requirement by the initial users of any new manufacturing facility included in the plan; however, failure to take such actions or obtain such compliance shall not affect the validity of any proceedings for the creation of the district, the existence of the district, or the validity of any debt instruments issued under Article 6 of Chapter 159 of the General Statutes. All findings and determinations made by the Secretary of Commerce under this subsection shall be binding and conclusive. For purposes of this section, the term 'manufacturing facility' means any facility that is used in the manufacturing or production of tangible personal property, including the processing resulting in a change in the condition of the property.

(e) County Review. – Before adopting a plan for a development financing district, the city council shall send notice of the plan, by first-class mail, to the board of county commissioners of the county or counties in which the development financing district is located. The person mailing the notice shall certify that fact, and the date thereof, to the city council, and the certificate is conclusive in the absence of fraud. Unless the board of county commissioners (or either board, if the district is in two counties) by resolution disapproves the proposed plan within 28 days after the date the notice is mailed, the city council may proceed to adopt the plan.

(f) Environmental Review. – Before adopting a plan for development financing districts, the city council shall submit the plan to the Secretary of Environment and Natural Resources to review to determine if the construction and operation of any new manufacturing facility in the district will have a materially adverse effect on the environment and whether the company that will operate the facility has operated in substantial compliance with federal and State laws, regulations, and rules for the protection of the environment. If the Secretary finds that the new manufacturing facility will not have a materially adverse effect on the environment and that the company that will operate the facility has operated other facilities in compliance with environmental requirements, the Secretary shall approve the plan. In making the determination on environmental impact, the Secretary shall use the same criteria that apply to the determination under G.S. 159C-7 of whether an industrial project will have a materially adverse effect on the environment. The findings of the Secretary are conclusive and binding.

(g) Plan Adoption. – Before adopting a plan for a development financing district, the city council shall hold a public hearing on the plan. The council shall, no less than 30 days before the day of hearing, cause notice of the hearing to be mailed by first-class mail to all property owners and mailing addresses within the proposed development financing district. The council shall also, no more than 30 days and no less than 14 days before the day of the hearing, cause notice of the hearing to be published once in a newspaper of general circulation in the city. The notice shall state the time and place of the hearing, shall specify its purpose, and shall state that a copy of the proposed plan is available for public inspection in the office of the city clerk. At the public hearing, the council shall hear anyone who wishes to speak with respect to the proposed district and proposed plan. Unless a board of county commissioners or the Secretary of Environment and Natural Resources has disapproved the plan pursuant to subsection (e) or (f) of this section, the council may adopt the plan, with or without amendment, at any time after the public hearing. However, the plan and the district do not become effective until the city's application to issue project development financing debt instruments has been approved by the Local Government Commission, pursuant to Article 6 of Chapter 159 of the General Statutes.

(h) Plan Modification. – Subject to the limitations of this subsection, a city council may, after the effective date of the district, amend a development

financing plan adopted for a development financing district. Before making any amendment, the city council shall follow the procedures and meet the requirements of subsections (d) through (g) of this section. The boundaries of the district may be enlarged only during the first five years after the effective date of the district and only if the area to be added has been or is about to be developed and the development is primarily attributable to development that has occurred within the district, as certified by the Local Government Commission. The boundaries of the district may be reduced at any time, but the city may agree with the holders of any project development financing debt instruments to restrict its power to reduce district boundaries.

(i) Plan Implementation. – In implementing a development financing plan, a city may act directly, through a redevelopment commission, through one or more contracts with private agencies, or by any combination of these."

SECTION 19. G.S. 158-7.3 is reenacted and rewritten to read:

"**§ 158-7.3. Development financing.**

(a) Definitions. – The following definitions apply in this section:

(1) Development project. – A capital project that includes capital expenditures by both private persons and one or more units of local government and that increases net employment opportunities for residents of the development district or within a two-mile radius of the project, whichever is larger, and increases the local government tax base.

If the district in which such a project will occur is outside a city's central business district (as that district is defined by resolution of the city council, which definition is binding and conclusive), then, of the private development forecast for a development project by the development financing plan for the district in which the project will occur, a maximum of twenty percent (20%) of the plan's estimated square footage of floor space may be proposed for use in retail sales, hotels, banking, and financial services offered directly to consumers, and other commercial uses other than office space.

(2) Publish. – Insertion in a newspaper qualified under G.S. 1-597 to publish legal advertisements in the county or counties in which the unit is located.

(3) Unit or unit of local government. – A county, city, town, or incorporated village.

(b) Authorization. – A unit of local government may finance public improvements that are part of a development project with the proceeds of project development financing debt instruments, issued pursuant to Article 6 of Chapter 159 of the General Statutes, together with any other revenues that are available to the unit. Before it receives the approval of the Local Government Commission for issuance of project development financing debt instruments, the unit's governing body must define a development financing district and adopt a development financing plan for the district. The county may act jointly with a city to finance a project, define a development financing district that is within the city, and adopt a development financing plan for the district.

(c) Development Financing District. – A development financing district created pursuant to this section must be comprised of property that is one or more of the following:

(1) Blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed from the standpoint of sound community development and growth.

(2) Appropriate for rehabilitation or conservation activities.

(3) Appropriate for the economic development of the community.

The total land area within development financing districts in a unit, including development financing districts created pursuant to G.S. 160A-515.1, may not exceed five percent (5%) of the total land area of the unit. A county may not include in a district created pursuant to this section any land that, at the time the district is created, is inside a city, town, or incorporated village.

(d) Development Financing Plan. – The development financing plan must include all of the following:

(1) A description of the boundaries of the development financing district.
(2) A description of the proposed development of the district, 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.
(5) The base valuation of the development financing district.
(6) The projected incremental valuation of the development financing district.
(7) The estimated duration of the development financing district.
(8) A description of how the proposed development of the district, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, or services.
(9) A description of the appropriate ameliorative activities which will be undertaken if the proposed projects have a negative impact on residents or business owners of the district in terms of jobs, affordable housing, services, or displacement.
(10) A requirement that the initial users of any new manufacturing facilities that will be located in the district and that are included in the plan will comply with the wage requirements referred to in subsection (e) of this section.

(e) Wage Requirements. – A development financing plan shall include a requirement that the initial users of a new manufacturing facility to be located in the district and included in the plan must pay its employees an average weekly manufacturing wage that is either above the average manufacturing wage paid in the county in which the district will be located or not less than ten percent (10%) above the average weekly manufacturing wage paid in the State. The plan may include information on the wages to be paid by the initial users of a new manufacturing facility to its employees and any provisions necessary to implement the wage requirement. The issuing unit's governing body shall not adopt a plan until the Secretary of Commerce certifies that the Secretary has reviewed the average weekly manufacturing wage required by the plan to be paid to the employees of a new manufacturing facility and has found either (i) that the wages proposed by the initial users of a new manufacturing facility are in compliance with the amount required by this subsection or (ii) that the plan is exempt from the requirement of this subsection. The Secretary of Commerce may exempt a plan from the requirement of this subsection if the Secretary receives a resolution from the issuing unit's governing body requesting an exemption from the wage requirement and a letter from an appropriate State official, selected by the Secretary, finding that unemployment in the county in which the proposed district is to be located is especially severe. Upon the creation of the district, the unit of local government proposing the creation of the district shall take any lawful actions necessary to require compliance with the applicable wage requirement by the initial users of any new manufacturing facility included in the plan; however,

failure to take such actions or obtain such compliance shall not affect the validity of any proceedings for the creation of the district, the existence of the district, or the validity of any debt instruments issued under Article 6 of Chapter 159 of the General Statutes. All findings and determinations made by the Secretary of Commerce under this subsection shall be binding and conclusive. For purposes of this section, the term 'manufacturing facility' means any facility that is used in the manufacturing or production of tangible personal property, including the processing resulting in a change in the condition of the property.

(f) County Review. – If the unit creating a development financing district and adopting a development financing plan is a city, town, or incorporated village, before adopting the plan the unit's governing body shall send notice of the plan, by first-class mail, to the board of county commissioners of the county or counties in which the development financing district is located. The person mailing the notice shall certify that fact, and the date thereof, to the governing body, and the certificate is conclusive in the absence of fraud. Unless the board of county commissioners (or either board, if the district is in two counties) by resolution disapproves the proposed plan within 28 days after the date the notice is mailed, the governing body may proceed to adopt the plan.

(g) Environmental Review. – Before adopting a plan for development financing districts, the issuing unit's governing body shall submit the plan to the Secretary of Environment and Natural Resources to review to determine if the construction and operation of any new manufacturing facility in the district will have a materially adverse effect on the environment and whether the company that will operate the facility has operated in substantial compliance with federal and State laws, regulations, and rules for the protection of the environment. If the Secretary finds that the new manufacturing facility will not have a materially adverse effect on the environment and that the company that will operate the facility has operated other facilities in compliance with environmental requirements, the Secretary shall approve the plan. In making the determination on environmental impact, the Secretary shall use the same criteria that apply to the determination under G.S. 159C-7 of whether an industrial project will have a materially adverse effect on the environment. The findings of the Secretary are conclusive and binding.

(h) Plan Adoption. – Before adopting a plan for a development financing district, the issuing unit's governing body shall hold a public hearing on the plan. The governing body shall, no more than 30 days and no less than 14 days before the day of the hearing, cause notice of the hearing to be published once and shall cause notice of the hearing to be mailed, by first-class mail, to all property owners and mailing addresses of the development financing district and to the governing body of any special district, as defined by G.S. 159-7, within which the development financing district is located. The notice shall state the time and place of the hearing, shall specify its purpose, and shall state that a copy of the proposed plan is available for public inspection in the office of the unit's clerk. At the public hearing, the governing body shall hear anyone who wishes to speak with respect to the proposed district and proposed plan. Unless a board of county commissioners or the Secretary of Environment and Natural Resources has disapproved the plan pursuant to subsection (f) or (g) of this section, the governing body may adopt the plan, with or without amendment, at any time after the public hearing. However, the plan and the district do not become effective until the unit's application to issue project development financing debt instruments has been approved by the Local Government Commission, pursuant to Article 6 of Chapter 159 of the General Statutes.

(i) Plan Modification. – Subject to the limitations of this subsection, a governing body may, after the effective date of the district, amend a development

financing plan adopted for a development financing district. Before making any amendment, the governing body shall follow the procedures and meet the requirements of subsections (e) through (h) of this section. The boundaries of the district may be enlarged only during the first five years after the effective date of the district and only if the area to be added has been or is about to be developed and the development is primarily attributable to development that has occurred within the district, as certified by the Local Government Commission. The boundaries of the district may be reduced at any time, but the unit may agree with the holders of any project development financing debt instruments to restrict its power to reduce district boundaries.

(j) Plan Implementation. – In implementing a development financing plan, a unit may act directly, through one or more contracts with other public agencies, through one or more contracts with private agencies, or by any combination thereof."

SECTION 20. G.S. 105-284 is amended by adding a new subsection to read:

"(d) Property that is in a development financing district and that is subject to an agreement entered into pursuant to G.S. 159-108 shall be assessed at its true value or at the minimum value set out in the agreement, whichever is greater."

SECTION 21. G.S. 105-277.11 is reenacted and rewritten to read:

"**§ 105-277.11. Taxation of property subject to a development financing district agreement.**

Property that is in a development financing district established pursuant to G.S. 160A-515.1 or G.S. 158-7.3 and that is subject to an agreement entered into pursuant to G.S. 159-108, shall, pursuant to Article V, Section 14 of the North Carolina Constitution, be assessed for taxation at the greater of its true value or the minimum value established in the agreement."

SECTION 22. Liberal Construction. This act, being necessary for the prosperity and welfare of the State and its inhabitants, shall be liberally construed to effect these purposes.

SECTION 23. Severability. If any clause or other portion of this act is held invalid, that decision shall not affect the validity of the remaining portions of this act, which are severable.

SECTION 24. The amendment set out in Section 1 of this act shall be submitted to the qualified voters of the State at the statewide general election in November 2004, which election shall be conducted under the laws then governing elections in the State. Ballots, voting systems, or both may be used in accordance with Chapter 163 of the General Statutes. The question to be used in the voting systems and ballots shall be:

"[ ] FOR [ ] AGAINST

Constitutional amendment to promote local economic and community development projects by (i) permitting the General Assembly to enact general laws giving counties, cities, and towns the power to finance public improvements associated with qualified private economic and community improvements within development districts, as long as the financing is secured by the additional tax revenues resulting from the enhanced property value within the development district and is not secured by a pledge of the local government's faith and credit or general taxing authority, which financing is not subject to a referendum; and (ii) permitting the owners of property in the development district to agree to a minimum tax value for their property, which is binding on future owners as long as the development district is in existence."

SECTION 25. If a majority of votes cast on the question are in favor of the amendment set out in Section 1 of this act, the State Board of Elections shall certify the amendment to the Secretary of State. The amendment set out in Section

1 of this act and the amendments set out in Sections 2 through 21 of this act become effective upon this certification. The Secretary of State shall enroll the amendment so certified among the permanent records of that office. If a majority of votes cast on the question are not in favor of the amendment set out in Section 1 of this act, that amendment and the amendments set out in Sections 2 through 21 of this act do not go into effect.

SECTION 26. This act is effective when it becomes law.

In the General Assembly read three times and ratified this the 19th day of July, 2003.

s/ Beverly E. Perdue
President of the Senate

s/ James B. Black
Speaker of the House of Representatives

s/ Michael F. Easley
Governor

Approved 5:37 p.m. this 7th day of August, 2003

Appendix D

Session Law 2005-407/Senate Bill 528 may also be found on the state website as follows:
http://www.ncleg.net/Sessions/2005/Bills/Senate/HTML/S528v5.html

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005

SESSION LAW 2005-407
SENATE BILL 528

AN ACT TO ALLOW A MUNICIPALITY TO USE PROJECT DEVELOPMENT FINANCING FOR TOURISM-RELATED DEVELOPMENT PROJECTS LOCATED IN AN ENTERPRISE TIER ONE AREA.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 158-7.3(a)(1) reads as rewritten:

"(a) Definitions. – The following definitions apply in this section:

(1) Development project. – A capital project that includes capital expenditures by both private persons and one or more units of local government and that increases net employment opportunities for residents of the development district or within a two-mile radius of the project, whichever is larger, and increases the local government tax base.

If the district in which such a project will occur is outside a city's central business district (as that district is defined by resolution of the city council, which definition is binding and conclusive), then, of the private development forecast for a development project by the development financing plan for the district in which the project will occur, a maximum of twenty percent (20%) of the plan's estimated square footage of floor space may be proposed for use in retail sales, hotels, banking, and financial services offered directly to consumers, and other commercial uses other than office space. The twenty percent (20%) limitation in the preceding sentence does not apply to development financing districts located in an enterprise tier one area, as defined in G.S. 105-129.3, and created primarily for tourism-related economic development, such as developments featuring facilities for exhibitions, athletic and cultural events, show and public gatherings, racing facilities, parks and recreation facilities, art galleries, museums, and art centers."

SECTION 2. This act is effective when it becomes law.

In the General Assembly read three times and ratified this the 24th day of August, 2005.

s/ Beverly E. Perdue
President of the Senate

s/ James B. Black
Speaker of the House of Representatives

s/ Michael F. Easley
Governor

Approved 1:15 p.m. this 20th day of September, 2005

Appendix E

A Discussion of the Economic Model of the Real Estate Market and the Development Process

We begin by describing the general development process. We assume that at time 0 an individual developer can purchase or currently owns a piece of land. Upon this piece of land the developer can develop N buildings at some point in the future. We assume that the buildings will have 50 year economic lives once they are constructed. The developer chooses when to begin construction, and once construction starts it will take T^C months to complete the construction process.[128] To maintain economies of scale, the builder will construct all N buildings simultaneously. To mitigate risk, the developer will seek to pre-sell units prior to construction and during the construction period, with delivery of the pre-sold units upon construction completion. When a unit is pre-sold, the developer is paid a fixed down-payment amount. At the closing the purchaser will pay the then-prevailing market price for the unit less a credit for their down payment. Should the developer be unable to pre-sell their entire inventory of buildings, they will sell these buildings after construction in the spot market. By modeling this process we can determine how much a purely rational developer would pay for the land to develop such a project in the future.

Before modeling the process for determining land value, we must first develop a number of the model's sub-components. These include features such as the process that lease prices follow, the building price function, the developer cash flows, and, ultimately,

[128] We do have to place a constraint on the developer's option to begin development: they must do so prior to reaching some development horizon, T^H. We set this development horizon far enough into the future where discounting effects will render it moot. Normally we set this to 15 years in our numerical solutions.

the land value function.[129] We define these components in the sub-sections that follow. Since ultimately lease prices determine other values within the model, they are the fundamental elements upon which we build the rest of the model.

The Lease Price Processes and Building Values

We model the real estate lease market as fully competitive. Building owners are price takes with respect to market equilibrium spot lease rates where the equilibrium price will be determined endogenously within the model. We assume that leases for space are continuously rolled over each period, and that the spot lease prices follow a mean-reverting stochastic process. This process reflects a real estate market where time to build for new development causes an inelastic supply of space in the short-term. Thus, lease prices adjust (revert) to a long-run equilibrium over time.

Demand for space within the market is driven by a distribution of potential tenants who demand space as an input necessary for the operation of their businesses. These tenants are heterogeneous with respect to the reservation price at which they are willing to rent available space. The distribution of tenants has an average spot lease reservation price R(t), and when the market's spot lease price P(t) is above an individual tenant's lease reservation price, it is not economically viable for the potential tenant to lease the space, and they will not do so. The average reservation price also follows a mean-reverting stochastic process to reflect a general economy that is cyclical in nature but adjusts to a long-run equilibrium over time.

[129] For residential development, this model still holds except that lease rates would represent service flows (i.e., implicit rent) to the homeowner, commercial space would instead be homes, landlords would residential developers/homebuilders, and tenants would be homebuyers. For purposes of the discussion we will assume commercial development throughout the write-up.

In this economy the average market spot lease price will be positively correlated with reservation price. This reflects increased (decreased) spot lease prices in the short-term with increased (decreased) demand for space. Increased (decreased) demand for space is reflected by higher (lower) reservation prices. In the long-term, supply changes in response to reservation price shocks will adjust lease prices to equilibrium over time.

We assume that landlords enter into long-term floating rate leases with tenants, i.e. the future lease payments will be set to whatever the current periodic market lease rate is. Thus a leased building will be worth the present value of the expected future cash flows over the life of the building, T^B.[130] Thus given a current spot lease rate P_t , an economic life of the building T^B, and some parameters from the lease price process, we can fully determine the value of the building in closed-form.

Purchaser Arrivals and Departures Processes

The developer observes, the process by which potential building purchasers arrives, is the process through which individual tenants arrive in the marketplace.[131] We begin with the notion that individual tenants who are willing and able to lease vacant space, i.e. those tenants with individual reservation prices, greater than or equal to the current market price, arrive randomly according to a Poisson process. We model the mean rate of arrivals for this process at time t as a function of the average spot lease reservation price R(t), and the market spot lease price P(t).

[130] For simplicity we assume that once a lease is signed both parties fully live up to that lease agreement. See Buttimer and Ott (2006) for a model in which tenants and landlords are allowed to default.
[131] One could assume, without loss of generality, that it is the tenant (i.e. the end-user) that is purchasing the building. They would still pay the present value of the future implicit rent payments for that building. We chose to maintain the conceit of separate tenants and landlords for ease of exposition.

If a potential purchaser does arrive - and if the developer has available inventory - then a sale immediately occurs. Of course if the development process has not yet happened, no immediate sale can occur. The most that can happen is that the purchaser can enter into a contract with the developer to construct the building. Although we assume that the developer requires the purchaser to make a down payment when they sign the sales contract, we do allow for the purchaser to back out of the sales contract prior to the beginning of construction. If this happens the purchaser forfeits their down payment.

Tenants can depart and we assume that for a given set of market conditions P(t) and R(t) this will occur according to a Poisson process. We model the mean rate of departures for the process at time t also as a function of the average spot reservation price R(t) and the market spot lease price P(t). We do assume, however, that once construction starts, the buyer is locked into purchasing the unit at the end of construction. In essence this means that the developer only faces purchaser departures in the pre-development phase of the project.

Project Cash Flows

Armed with the evolution of the market lease price (P) and average tenant reservation price (R), we can begin to discuss the cash flows that the developer will receive. These cash flows will vary depending upon where the developer is in the development cycle. We can consider the cash-flows in four distinct regimes: pre-construction, during construction, at construction completion, and post-construction.

Pre-Construction Cash Flows

We assume that prior to construction the developer faces some minimal level of fixed costs each period. These costs represent basic ownership costs such as property taxes, hazard insurance, and basic property-rights enforcement. We assume that these costs are a function of the size of the property and as a result represent them as being a function of the number of units that can be built on the property (N.) That is, we actually specify a per-building lot cost, $VC^{\text{Pre-development}}$, and then assume that the total cost to the developer is the product of that cost and the number of lots. Thus the costs to the developer of holding the undeveloped land each period as:

$$Cost^{\text{Pre-development}} = N * VC^{\text{Pre-development}}$$

The developer can, of course, pre-sell buildings prior to construction. If the developer does pre-sell a unit we assume that they immediately receive a down-payment from the purchaser, but that they will receive the bulk of their payment upon the completion of the building. The buyer contracts to pay the prevailing market building value at the closing less a credit for the initial down-payment they received. To induce pre-sales, however, we allow the developer to charge a lower down-payment amount in the pre-construction period than the credit that is ultimately applied at the closing. Thus, if in a given pre-construction period the developer sells n units, the cash flow that the developer receives in that period is:

$$Revenue^{pre-development} = n * (Credit * pre\_development\_discount).$$

We can determine the developer's net income in a pre-development period, $\theta^{Pre\text{-}development}$:

$$\theta_n^{Pre-development} = n * (Credit * discount_{pre-development}) - N * VC^{Pre-development}.$$

Construction Cash Flows

During construction the developer will face a very different set of cash flows, primarily driven by the construction costs that they must bear. We assume that the developer bears these construction costs linearly over the construction period. That is, we assume that once the developer decides to start construction that they will need T^C months to complete construction. We further assume that each period they must pay $1/T^C$ of the total construction costs (*CC*) that they will ultimately face. We also assume that with construction they are likely to begin facing higher holding costs, which we denote as simply as *VC*. We assume that they must pay these costs *VC* on every unit under construction, even those that have been pre-sold. Thus, the developer's cost in a given construction period is given by:

$$Cost^{In\text{-}development} = N * VC + \frac{CC}{T^C}.$$

The developer can, of course, sell any available units during the construction period. We assume that if they do make a sale, the purchaser makes a down-payment that is credited back to them at the closing, which we denote as *Credit*. Thus, for n units sold, the developer's revenue in the period is given by:

$$Revenue^{In-development} = n * Credit,$$

and so their net income is given by:

$$\theta_n^{In-development} = n * Credit - \left(N * VC + \frac{CC}{T^C} \right).$$

Cash Flows Upon Construction Completion

The model assumes that development take T^C time steps to complete. In the T^C+1 time step after the commencement of construction, the model assumes that the developer and purchasers close on all pre-sold units. With that closing, the developer no longer bears any costs from the sold units. The developer does, however, continue to pay holding costs on any unsold units. Thus, the developer's cost in the period when construction is completed is given by:

$$Cost^{Construction\ Completion} = N^{remaining} * VC,$$

where $N^{remaining}$ is the number of units that have not been sold.

The revenues are more complex because the developer will get paid for any pre-sales that were made and for any spot-market sales that are made in this period. Denoting the number of pre-sales as $n^{pre\text{-}sales}$ and the number of current period spot-sales as n^{spot}, the revenues for this period are:

$$Revenues^{Construction\ Complete} = n^{pre-sales} * (B - Credit) + n^{spot} * B,$$

where B is the current value of a building conditional upon the values of P and R. For the pre-sold units we subtract from the current building spot price the credit the purchaser receives for their down payment. The developer's net income for the period in which construction is complete and in which pre-sold units are closed.

$$\theta^{Construction\ Complete}_{n^{pre-sales}, n^{spot}} = \left[n^{pre-sales} * (B - Credit) + n^{spot} * B \right] - N^{remaining} * VC$$

Post-Development Cash Flows

In the periods after development, the cash flows to the developer are relatively straightforward. They must continue to pay holding costs on any units that are unsold,

and if a sale is made they receive the value of the building, B. Thus, given n^{spot} sales in a given period, the developer's net-revenues are given by:

$$\theta_n^{Post-development} = \left[n^{spot} * B \right] - N^{remaining} * VC .$$

Note that we assume that the developer pays holding costs for this period on units that they held at the beginning of the period. As a result $N^{remaining}$ is by definition greater than or equal to n^{spot}.

We now have in place all of the pieces needed to model the developer's options, and ultimately to determine the value of the undeveloped land to the developer.

Model Solution and Outputs

We determine the value of the development project, using standard contingent claims analysis (dynamic programming) subject to a set of value matching conditions to reflect the valuation upon a sale of one of the buildings in the development, and also a set of maximization boundary conditions to reflect the option of the developer to sell additional buildings upon the arrival of additional purchasers. Solution of the model will allow is to compute:

- Land values and completed project values
- Presale requirements to begin construction
- Expected time to begin development and complete construction
- Equilibrium lease rates and/or home prices at which development will occur
- Expected market absorption of space or units
- Expected property tax revenues over time
- A determination of the economic efficiency of the TIF investment for the funding tax districts

Appendix F

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