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IQ SERVICE REPORT

INTRODUCTION TO INFRASTRUCTURE FINANCING (Excerpts)

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

TABLE OF CONTENTS (IN FULL REPORT)

INFRASTRUCTURE FUNDING CONSIDERATIONS SEVEN COMMON REVENUE SOURCES

Property Tax
Local Option Sales Tax
Income Tax
Special Purpose Tax
Gas Tax
Excise Tax
Real Estate Transfer Tax

BONDS SPECIFIC PURPOSE REVENUES AND FINANCING MECHANISMS

User Charges
Stormwater and Transportation Utilities
Congestion Pricing and Tolls
Lease-Purchase Contracts and Certificates of Participation (COPs)
Special Assessment Districts
Business Improvement Districts (BIDs)
Special Taxing Districts
Utility Districts
Tax Increment Financing (TIF)

PARTNERING

Privatization or Public-Private Partnership
Jurisdictional Revenue Sharing

DEVELOPER CONTRIBUTIONS

Exactions
Impact Fees

STATE SOURCES

Bond Banks
Revolving Loan Funds
Growth Management Rewards

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

The remainder of this report discusses the topic Infrastructure Funding Considerations and three of the 24 categories. The three categories are stormwater and transportation utilities, jurisdictional revenue sharing and impact fees.

INFRASTRUCTURE FUNDING CONSIDERATIONS

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

Unfortunately, the funding options that offer the closest nexus with the demand for public facilities also have the smallest demand base to bear the cost of the public facilities (see the right side of Exhibit 1). The smallest revenue base for funding capital improvements is the area-specific assessment. For impact fees, the revenue base may vary by geographic service areas, or may include all development within a juris-

The Introduction to Infrastructure Financing Report highlights basic differences between funding options as well as the trade-offs that local governments must consider.”

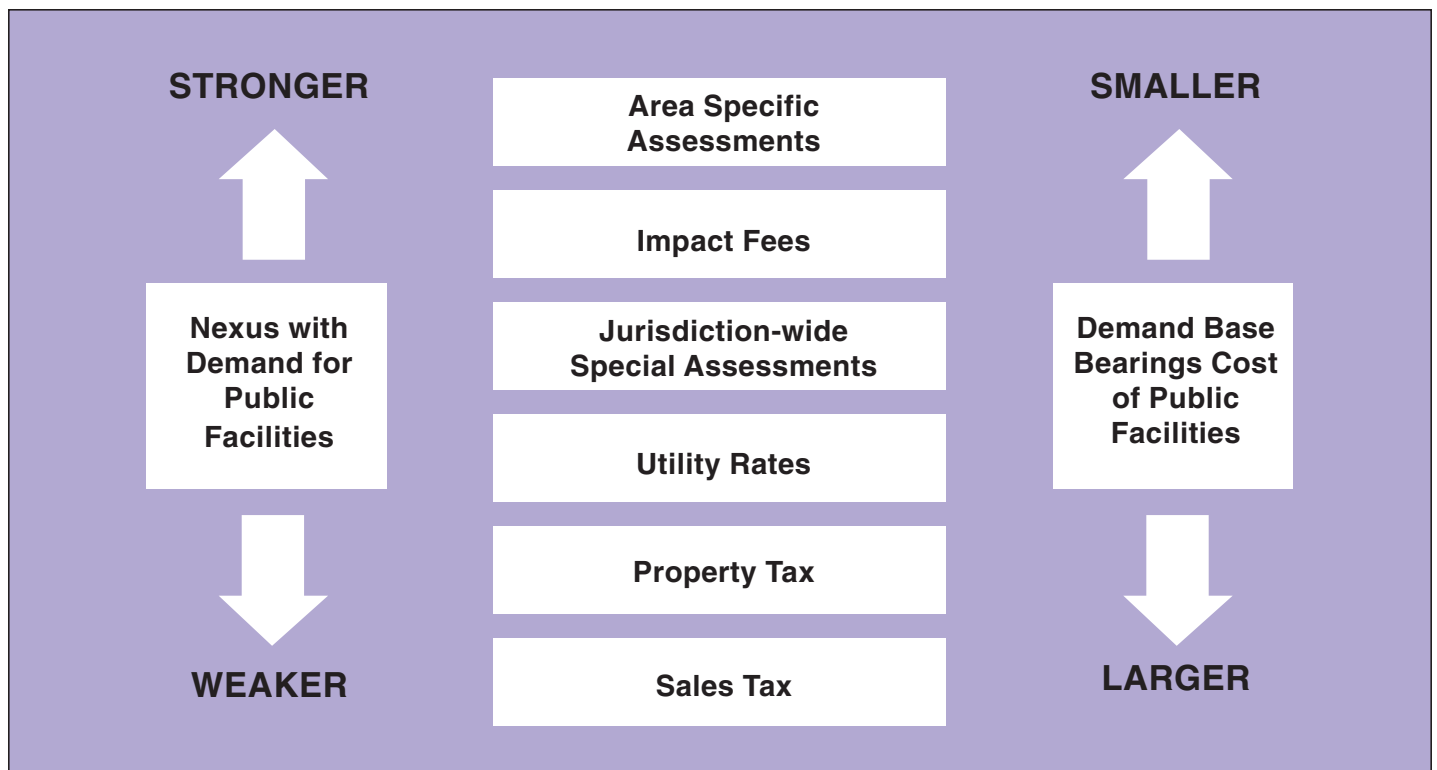
dition. But even if impact fees are collected from all new development in a jurisdiction, the magnitude of the fees collected depends on the annual increase in development. In contrast, sales tax revenue is collected from a large revenue base

Paul Tischler has over 30 years of fiscal and economic consulting experience. Under his leadership TischlerBise has completed over 500 impact fee assignments, 400 fiscal impact evaluations, and numerous revenue strategies.

Dwayne Guthrie has more than 26 years of relevant fiscal and economic experience. He has prepared impact fees for approximately 70 jurisdictions in 21 states.

Nadejda Mishkovsky, a former intern with TischlerBise, provided research for this IQ Report.

Exhibit 1 — Funding Sources by Demand and Size of Funding Base



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

Exhibit 2 — A Ranking of Funding Sources

that may in fact be larger than the jurisdiction that is collecting the fees. For example, a jurisdiction may serve as the commercial center of a large, regional market area. In this case, the sales tax collections are based on the buying power of the region.

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

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

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

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

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

Stormwater and Transportation Utilities

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

mensurate growth in general fund revenues.

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

The funding sources with strongest connection to the demand for public facilities include area-specific assessments and impact fees."

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

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

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

Advantages.

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

- Fees are not part of property tax rates and not part of the general fund budget.

Disadvantages.

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

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

The city of Ashland, Oregon, has a transportation utility fee (TUF) that supports street maintenance, pedestrian facilities, handicapped access, and bicycle facilities. The TUF fund also pays for portions of local bus service. The fee, charged as part of the local monthly utility bill, is a flat fee for residential properties – \$3.27 for single-family dwellings and \$2.49 for multifamily dwellings. Fees for commercial development are based on the type of business and the number of trips the business is likely to generate. Rates range from \$0.15 per 100 square feet for a business with low trip-generation, such as a warehouse, to \$1.17 per 100 square feet for high-traffic businesses such as a retail uses and offices.

Jurisdictional Revenue Sharing

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

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

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

ⁱ Susan P. Schoettle and David G. Richardson, "Nontraditional Uses of the Utility Concept to Fund Public Facilities," *The Urban Lawyer*, vol 25, no. 3. (Summer 1993): 519-537.

Advantages.

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

Disadvantages.

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

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

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

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

Westminster and Thornton, Colorado, two municipalities in the Denver area, cooperate to share sales taxes from a discrete area at their boundary. The sales tax is a significant source of revenue and it is based on point of sale. In the interest of better planning, and to avoid offering competing incentives to attract retailers, the two cities decided to each annex one side of a four-mile portion of Interstate 25.

According to their agreement, one third of sales and admissions tax revenues are retained by the jurisdiction that collects the tax, and the remaining two thirds are shared, based upon the percentage that each locality’s tax rate constitutes of the total of the two tax rates combined.

Impact Fees

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

Jurisdictional revenue sharing has an equalizing effect, allowing an economically weaker jurisdiction to avoid offering expensive incentives to prevent employment from relocating, for example.”

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

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

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

The *buy-in* methodology is used when the local government has already oversized capital facilities from which new growth will benefit. An example might be a wastewater treatment plant constructed with bond financing that has excess

capacity intended to accommodate future growth. This approach can be used with either of the first two approaches. All information and growth forecasts available when the impact fee is calculated and adopted can be used.

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

“Impact fees are one-time cash payments to pay for the new development’s fair share of capital facilities.”

Advantages.

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

“Impact fees add certainty to the development process by encouraging capital improvement plans, providing funding for infrastructure, and providing developers and builders with a specific, known fee schedule.”

Disadvantages.

- Impact fees go only to pay for capital facilities benefiting the payer and cannot be used for operating expenses operating expenses usually account for 80 to 90 percent of a jurisdiction’s budget).
- The collected fees must be spent within a reasonable time period, often about six years.
- A jurisdiction may not use impact fees to support a higher level of service, unless it has a plan in place to address deficiencies created by the existing development.
- Some new homebuyers may already be residents within the jurisdiction; they have already been paying for capital facility needs through the existing tax base.
- New homebuyers are forced to “buy into” the capital facilities with a one-time fee, as opposed to the traditional application of taxation to finance capital facilities.
- Since impact fees are collected from new growth only, they do not ensure a steady source of revenue.
- Since the formulas for calculating impact fees are usually quite rigorous in reflecting proportional costs, rational nexus criteria, and credits (to avoid double payment), jurisdictions usually need outside expert help to institute impact fees.

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



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