

# **NORTH CAROLINA'S NEWEST ECONOMIC DEVELOPMENT TOOL – TAX INCREMENT FINANCING**

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On November 2, 2004, North Carolina voters approved an amendment to the State Constitution to allow a special type of financing to be used for economic development projects throughout the State.

The approval of “Amendment One,” as it was labeled, triggered the effectiveness of the North Carolina Project Development Financing Act. The Act authorizes counties, cities and towns to issue “special development bonds” for public improvements that are needed for the development of new businesses and neighborhoods.

Better known as “tax increment financing” bonds (TIF) or “self financing bonds,” this form of financing has been used throughout the United States for many years. In fact, before the amendment was adopted, only two states – Arizona and North Carolina – did not allow TIF bonds to be issued.

Tax increment financing can be used for a wide variety of public projects, including street improvements, water and sewer utilities, transportation systems, parking facilities, neighborhood revitalization projects, and many other purposes. The only limitation is that the proceeds must be used for projects that enable, facilitate, or benefit private development within the special district.

What is unique about TIFs? Unlike most public bonds – which are backed by the faith and credit of the town or county issuing them or from revenues from specific projects – TIF bonds are repaid only from the incremental property taxes resulting from the increased value of property within a specially designated development financing district. County residents and businesses that do not reside within the financing district will not be taxed to pay debt service on the bonds; those that do reside within the district will only pay their normal property taxes.

If property tax receipts from the district increase from a base established at the time the TIF bonds are issued, due to either a higher assessed value of property or higher tax rates, the incremental taxes will be used to make payments on the TIF bonds. Residents within a district cannot be targeted for increased taxes simply because TIF bonds are outstanding. Rather, any increase must be on a countywide or citywide basis and achieved through the normal tax assessment process.

Here's how TIF bonds under the new Act will work.

If a county, town or city has an area that is blighted or appropriate for rehabilitation or the economic development of the community, it can create a “Development Financing District” encompassing the area. The district can be as small as a separate building, such as a warehouse,

former mill or manufacturing plant, or as large as several-hundred acres. The area within the district cannot exceed 5 percent of the local government's geographic area. In addition, only 20 percent of the private development can be for retail purposes – unless the district encompasses a city's central business district.

The county, town or city (i.e., a governmental unit) must determine that, “but for” the creation of the special district and the issuance of the TIF bonds, the project would not be constructed. The governmental unit must then produce a “Development Financing Plan” for the district that addresses the following:

- A description of the boundaries of the district;
- A description of the proposed development within the district, both public and private;
- The costs of the proposed public activities;
- The sources and amounts of funds to pay for the proposed public activities;
- The base valuation of the district;
- The projected incremental valuation of the district;
- The estimated duration of the district;
- 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;
- A description of the appropriate ameliorative activities that will be undertaken if the proposed projects have a negative impact on district residents; and
- A requirement that the owner of any new manufacturing facility included in the district will meet the minimum wage requirements (which are set forth below).

Once the area of the special district is identified and the development plan prepared, the governmental unit must apply to the Local Government Commission (LGC) for approval of the bonds. The LGC is the state's financial watchdog for local governments. It reviews the financial terms of all public debt to assure that the issuing governmental unit has adequate resources to pay its obligations.

In determining whether to approve the financing, the LGC will consider any matters it considers relevant to the proposal. These include whether the proposed project(s) is necessary to secure significant new economic development in the area; the feasibility of the project; the local governments debt management procedures and policies; whether the local government has defaulted on any of its other debt; whether private development in the proposed district would likely occur without the proposed project or the proposed financing; whether taxes on the incremental valuation of property in the proposed district will be sufficient to pay debt services on the financing as planned; and the ability of the LGC to market the proposed bonds at reasonable interest rates. The LGC may meet with local officials and members of the private development team to discuss details of the financing.

If the development plan includes building a new manufacturing facility, it must be approved by the Secretary of the Department of Environment and Natural Resources as well as by the LGC. The secretary will grant approval based on two factors: 1) the facility will not have

a materially adverse effect on the environment, and 2) the company operating the facility has operated other facilities in compliance with environmental requirements.

Additionally, the initial user of the new facility must pay its employees an average weekly manufacturing wage that is either more than the average for the proposed development district or at least 10 percent higher than the average weekly manufacturing wage paid in the state. The Secretary of Commerce can waive this wage requirement for areas of high unemployment.

In addition to obtaining LGC approval, before the local government can formally adopt a development plan, it must hold a public hearing on the proposal. Notice must be mailed to residents of the proposed district and published in the local newspaper at least 30 days prior to the hearing. If the local governmental unit is a town or city, it must notify the county government of the proposed plan and allow the county to hold its own hearings. If the county does not object to the plan within a prescribed period, the town or city may proceed with the financing.

A key component of the financing will be establishing the tax basis for the district, which in turn secures the source of repayment for the TIF bonds. When a territorial area is selected as a district, the tax assessor will determine the base valuation of the real and taxable personal property in that area. Thereafter, taxes levied on any excess in value of such property from its base valuation will be set aside to pay interest and principal on the TIF bonds. The governmental unit must keep a separate account (a "revenue increment fund") to collect taxes related to the incremental value of property within the district and to make payments on the TIF debt.

Local government units and property owners in a financing district can agree upon the minimum value of their real property within that district for the life of the financing. This will help assure that taxes will incrementally increase at sufficient levels to meet debt service on the TIF bonds. Payment risks to bondholders can also be mitigated through the acquisition of bond insurance by the town or county issuing the bonds. Additional protections are provided in the form of special reserve funds for the bonds and by imposing liens on the property being constructed for the benefit of a trustee for the bondholders. These protections will also enhance the marketability of the TIF bonds and reduce the interest rate on the debt.

This new form of financing is expected to result in the construction of many projects throughout North Carolina, providing new life to blighted areas and greater economic development opportunities to cities, towns, and counties.

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