Funding Workgroup Report #3
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Subject: Funding Work Group Interim Report

Background

The Blue Ribbon Commission on MD Transportation Funding (BRC) has released its final report. Several BRC recommendations fall in line with what we have been exploring. These ideas include the following.

1. Smart Growth Tax Increment Financing | expanding funding sources | partnerships
2. State Infrastructure Bank
3. Preserving agricultural and environmentally sensitive lands

At the core of the BRC recommendations are new fee proposals including a 15 cent increase in motor fuel taxes over three years. Beyond that, the following recommendations from that report reflect the direction the "Funding" effort is heading.

- Recommendations 13 & 14 - create a framework for directing transportation funding decisions to smart growth areas and preserve rural areas and work with local governments to ensure plans reflect state growth policies
    - This Funding Group update report highlights ideas for creating a partnership between state and local government where land use regulations create a regulatory framework that can capitalize on infrastructure investment to generate the tax "increments" to pay the bonds floated for the upfront funding
- Recommendations 15, 16 & 17 - promotes "value capture" as part of the infrastructure investment decision process and the necessity to "capture" the value of those investments through TIF
    - the recommendation only mentions "highway project development" and we are working to fund more than just that, like transit and possibly other infrastructure such as schools
- Recommendations 18 to 22 - addresses public private partnerships and fine tuning the process
    - There is enough work in the BRC report that the Funding Group need not move any further in this area
- Recommendation 23 - take advantage of any National Infrastructure Bank
    - Interestingly there is no mention of creating a state infrastructure bank as many other states do, this is important if funds are only to be directed into either the Transportation Trust Fund or be available for other infrastructure goals
    - We are working to assess other states infrastructure bank programs

Conclusion

We need additional revenue at the state and local level. Even revenue that may result if the BRC recommendations are adopted, the Transportation Trust Fund will still fall short of needed revenues to fund many of the major planned projects. Therefore significant local funding assistance will be needed. This means capturing some part of the increased value resulting from new investment in infrastructure. It also means new ideas of what revenue stream is being captured.

Tax Increment Financing Strategy for Smart Growth Areas

We are pursuing a Smart Growth Tax Increment Funding tool where the State and local governments work together to create a designated TIF district that "captures" increased tax revenue (increment) from infrastructure investment. The idea of combining two levels of government taxing tools as well as involving private investment raises a number of challenges.

Goals of Smart Growth Funding

- create new funding opportunities for infrastructure investment
- prioritize areas where the smart growth funding approach could be used
- create a partnership of government and the private sector to bring projects to reality, where each partner steps "up to the plate" to commit to a role and the means to achieve impact projects

As the discussion moves forward, a number of questions will need to be answered.

- what funds at the state level can be leveraged without running afoul of the state debt limits (8% of revenue)
- what types of infrastructure can the funding tool be used for? Only transportation, affordable housing, schools ?
- clearly there is a need for a greater local "match", with resources limited, a "local sales tax option" may be the best alternative, and around the country where this is used, it is "the money" generator, creating more revenue than property taxes

Smart Growth Infrastructure Funding (SGIZ) - Overview

Overview - What is the Smart Growth Infrastructure Funding Zone?

- a funding mechanism for infrastructure that will support | encourage efficient development patterns on land currently or easily serviceable
- provide infrastructure capital and long term service costs related to growth
- promote land use decisions that connect housing to jobs to infrastructure

- combines local and state resources through a shared decision making structure, to leverage resources through partnerships and the capacity of the State to bring major infrastructure goals to reality

How Does the Smart Growth Infrastructure Fund Work?

A SGIZ is a partnership that may include both state and local governments and the private sector. Like any TIF the objective is to capture "new tax revenue", meaning those taxes above the current level from the properties subject to the TIF. The current tax revenues continue to flow through to both the state and local government general revenue funds and that only the "new" taxes are dedicated to repay a specific infrastructure investment.

The innovative feature of this proposal is the dedication of both local and state tax increment to a specific project. This raises the question of "debt ceiling" for the state. Meaning the state cannot have a debt to revenue ratio greater than 8 percent, which is where the current ratio stands. Therefore any dedication of state revenue, even through a local TIF, means exceeding the ratio. So why move forward with the SGIZ?

- the goal is to have a mechanism in place that is there when the conditions are right, meaning as both local and state funds move past the current economic challenges, we have a tool in place that can be used to foster smart growth
- we are investigating alternatives to create revenue that avoids the debt ceiling, like a local sales tax option, so that the SGIZ could be used now

Details of the SGIZ

A SGIZ provides for the collection of dedicated local and state taxes |fees, above the current base levels, that are pledged towards the repayment of the costs for specified infrastructure projects. The time period would be set in the legislation but should not exceed 25 years.

- the increase in local taxes | fees are those above what is generated prior to the SGIZ, which result from property improvements within the defined boundaries. These taxes could include the increment or a portion of the increment of a variety of local taxes such as

property tax	any taxes levied through a special taxing district
mitigation fees	impact fees
land transfer fees	development application fees
building permit fees	

- if state legislation allowed, the local jurisdiction could assess a local sales tax dedicated to a specific infrastructure project
- all or some of the "increment" of State taxes collected within the defined SGIZ area could be targeted, including fuel taxes, registration fees or property taxes

- the tax revenues collected may vary from one project to the next depending upon funding levels and the projected revenue streams
- SGIZ provides for public private partnership agreements where revenue sharing is directed to the entity or entities who forward fund the improvements
- where a private entity is involved in forward funding, SGIZ provides for a tri-party agreement between the locality, state and the private entity, where the future tax revenue stream is divided between the parties in an agreed upon schedule for repayment;
    - identifying the sources of repayment funding and apportioned costs
    - the repayment schedule
    - revenue shortfall sources

The Real Value in a TIF

Many states allow for the "capture" of sales tax revenue in a TIF. This means that the increment in increased retail sales tax revenue levied by the locality is directed to the TIF revenue stream to repay bonds for some infrastructure improvement. Maryland does not currently make this tool available to local government.

The decision to "tax themselves" generally rests with the voters through a referendum. The ballot asks if voters are willing to incur a dedicated sales tax for specific infrastructure improvements. The bad examples nationwide are for sports stadiums, particularly football. However the good examples are many.

local sales tax option

This week Durham County N. Carolina has a referendum on the ballot for two types of local sales taxes. There is a measure to approve a ½ cent sales tax for a 17 mile light rail line to Chapel Hill; a 37 mile commuter rail line to Raleigh; and increase bus service by 44%. The County is also holding a vote on a ¼ cent increase for school and economic development funding. Orange and Wake Counties which are included in the rail proposal, have delayed the referendum over concerns of local tax increases in the current economic climate.

In a shrinking world of tax revenue, should MD have a "local" option to allow for voters to decide whether or not to tax themselves to pay for a local infrastructure improvement? If done right, the local sales taxes collected generally exceed property tax revenue.

Another important factor is that the decision making for the additional taxing authority rests with the voters of the locality where the infrastructure improvements would occur. For example, funding for recreation centers was a ballot initiative in a big mid west city that passed, and two new recreation centers are now operational.

What are Smart Growth Infrastructure Zone Eligible Areas ?

The SGIZ is a targeted mechanism that requires clear criteria for determining eligible areas. Maryland already has some guidance on this subject with the "priority funding areas" which may be too broad a definition, limiting the potential to create an "impact" that generates revenue streams necessary to repay the investment.

The new Plan MD definitions of "Growth and Revitalization Area" and "Established Community Area" may help in determining SGIT eligible areas. However, at the end of the day, it comes down to the "on the ground" entitlements that will generate smart growth and the associated revenue stream. This means zoning. Localities will have to "step up" and put in place the land use regulatory regime necessary to realize the potential created by major infrastructure investment. Overcoming potential local concerns about development may be necessary to fully realize the investment potential while creating smart growth areas.

The SGIZ areas may be nodes, meaning around a particular project, or a corridor, such as a new transit way. The key is to "capture" increased state and local revenue streams from the area to pay off the bonds needed to forward fund the improvement.

Below are some suggestions for defining where a SGIZ could be used and it does "prompt" localities to make decisions on programmed infrastructure projects and enacting zoning to allow for capitalizing on the investment.

General Requirements

- if a SGIZ is limited to transportation projects, the boundary should be areas within one mile of a transit station or transit line or transportation project identified in an adopted master plan, programmed in the localities current CIP and by the State
- public transit is defined as a fixed rail or dedicated lane rapid transit vehicle, or a non fixed route, where in either case service intervals are at a minimum of 15 minutes during peak commute hours
- where infrastructure in addition to transportation, such as schools, utilities and rec centers are eligible, the one mile radius could still apply
- the area must be within the State recognized Growth and Revitalization Area or an Established Community Area
- the SGIT area must encompass projects zoned and programmed for mixed uses including employment and residential uses with a range of housing costs and types with a majority for multi unit housing
- no net loss of housing affordable to persons of low and moderate income as determined by the census tract data for the locality where the SGIT area is located

Local Requirements

This is where the locality must step up to the plate and zone lands adjacent to the CIP programmed infrastructure improvement to take advantage of the dollars spent. Remember the goal is smart, mixed use growth. The SGIT is not intended to create a regional retail power centre but a walkable place where people can choose to live and work and shop.

Local commitment could take the form of specific policies in regional or local comprehensive plans, specific zoning requirements which are geared to smart growth development and programming in capital infrastructure plans.

- within the SGIZ eligible area, the local zoning is in place that achieves the following standards
    - no land is zoned for less than
        - a mix of uses where the minimum floor area dedicated to non residential uses is at least 20% and for residential uses 40%
        - a minimum floor area appropriate for locality but high enough to generate development of scale
        - a height limit of at least 70 feet to permit at a minimum, a multi unit "stick built" residential building
        - an affordable housing requirement of 20% of all new units
    - provide a cap on the amount of big box retail so that the area does not become a "retail power center"
    - all new units shall be located within one ½ mile of at least five basic services (grocery store, dry cleaner, restaurant, drug store, etc.)
    - maximum parking requirements averaged over a single development of
        - one space per 1,000 square feet of non-residential floor area
        - one space per dwelling unit

What Non Transportation Infrastructure Projects might be Eligible for the SGIT Program?

The focus of discussion has been on transportation project funding. Should the SGIZ also look at other public infrastructure projects or affordable housing? Any eligible project should be something with the potential to create a "smart growth areas". For example, poor school infrastructure may inhibit new residential and commercial investment. Utility infrastructure capacity may be limiting an area from growing. Should these types of projects be eligible? How would their impact be assessed to determine eligibility for funding?

What Transportation Infrastructure Projects are Eligible for the SGIZ Program?

Transportation eligible projects can include transit and automobile infrastructure. For example enhanced bus service or a new interchange where the land use within one mile is zoned and intended for smart growth development.

What Makes the Smart Growth Infrastructure TIF a Good Smart growth Policy?

Legislation that would bring some of the above ideas to the "funding toolbox" could have a real impact on bringing smart growth infrastructure to reality. A key factor is the requirement to "think about the future". A SGIZ would generate the following.

- long term regional transportation infrastructure thinking, linking land use, health, transportation and economic development, to cost efficient infrastructure decision making
- commitment for new sources of revenue to finance smart growth projects
- more private | public partnerships to build infrastructure sooner
- interest in the private sector to capitalize on the infrastructure investment
- economic development in "smart" locations, providing a higher rate of return in both government revenues and private revenues

Guarantees if the SGIZ Revenue Sources Fall Short of Repayment Schedules? (nonperformance)

Always a concern with a project "forward funded", is what happens if the projected revenue stream fails to meet expectations? How is the debt service met?

- SGIZ provides the initial investor, the entity or entities which provides the capital for the building of transportation infrastructure, with security should the taxing sources "captured" by the SGIZ fall short of projections
    - current MD laws provides for "Special Taxing Districts" to be established by the locality for transportation infrastructure projects
    - the revenues from the special taxing district could be collected for the purposes of guaranteeing the future SGIZ revenue stream
- the special taxing district revenues can be held for debt servicing and where a surplus is realized, used to pay down the debt in advance, keeping an annual reserve sufficient to repay any shortfall in the SGIZ revenue stream

Future Cost Servicing

Around the Country governments are finding that the cost of rebuilding infrastructure provided 50 years ago, is not covered by the tax revenues generated by the development served. The impact fees used on the "capital" costs, those associated when things were built, are not there to replace the aged sewer linea. SGIZ has the added benefit of planning for future maintenance and replacement costs of transportation infrastructure, where 10% of the bonding capacity is set aside in a fund administered by either the State or locality, depending upon maintenance responsibilities, for the purposes of maintaining or replacing the infrastructure funded by the SGIZ.

When the term of the SGIZ is expired, a small portion of the tax revenue should continue to flow through to the "maintenance fund".

Summary

It is important to remember that in the SGIZ proposal, the current taxes still flow through to intended sources such as the school share of local property taxes as well as the State general revenue from the gas tax, motor vehicle tax etc. The only taxes dedicated to the district are the increments. In effect, self taxing above the current state general fund commitments.

It is equally important to remember that additional taxes such as income tax generated by the new SGIT district would be new money for the State general fund and this represents a large chunk of money that would not have otherwise been created. So the SGIZ strategy maintains and increases local tax money going to state funds to be distributed throughout the state, as well as dedicating a smaller portion of tax increases to pay for the infrastructure improvements.

State Infrastructure Bank

The research on state run infrastructure banks shows a big range of dollar values and effectiveness. Some fund all modes of transportation while others focus on roads. Most still have the state generating the revenue to capitalize the fund and they end up looking like the Transportation Trust Fund in MD. The big “financiers” are South Carolina, Florida and beginning this year, Virginia. Requirements vary for the type of projects financed. For example Florida requires consistency with MPO and local government comprehensive plans. A quick overview of key points follows.

Initial Capitalization

The three states cited above all used state funds, mostly general revenue and some federal funds to capitalize their Infrastructure Funds. For example, this spring Virginia allocated $283 million from a fiscal year surplus coupled with savings from VDOT to get their fund started. Florida used general revenue bonds and ongoing state funds.

Ongoing Funding

Many of the funds set their own interest rates in lending and will lend to private borrowers. Repayment capacity is often based upon infrastructure revenue in the form of cash for loans to private borrowers and dedicated local taxes for public borrowers. Like any bank, the ability to repay is important in determining which projects are funded. Florida will defer repayment for up to five years to enable a project to begin to generate a return. Such funds roll the interest payments back into the fund.

Georgia uses motor fuel taxes as the primary funding source and the legislation prohibits the fund from investing in projects other than road related.

Things to Learn

The best state models may offer some tools to either fine tune the Transportation Trust Fund or create a mechanism to fund a range of infrastructure projects. A key is the nature of the projects that could be invested in, because not all infrastructure projects generate quantifiable returns, such as a school. The discussion above on the Smart Growth Infrastructure Zones may lend itself to an infrastructure bank model, where value capture of specific revenue streams within a defined boundary could create a perpetual revolving loan fund.

Next Steps

1. Work is progressing with staff from various state departments to move the SGIZ idea forward. Feedback on some of the issues is welcome such as the nature of projects that should be funding eligible is welcome. The goal is to produce legislation that may not achieve all of the the things outlined in this report but that could present a “sellable” strategy.

2. Discussions on enhanced tax credit ideas for the preservation of agricultural and environmentally sensitive land are moving forward. The goal is an outline of possible legislation changes.

3. In light of the BRC recommendations on public | private partnerships, that forum is the better place for any changes in legislation.

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