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## Coates' Canons Blog: Financing Capital Projects—Part II: Special Levies

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**UPDATE AUGUST 2013: The General Assembly extended the authority for the Newer Special Assessment Method. It was set to expire on July 1, 2013. It is now set to expire on July 1, 2015. The legislature also made a few important changes to the Newer Special Assessment authority. See S.L. 2013-371.**

Blight City has fallen on hard times. Its population has declined significantly since the 1990s, due in large part to the shuttering of two large manufacturing plants. Emblematic of the city's decline is its central downtown area. Once a vibrant community center, it is now comprised mainly of run-down, vacant buildings. Recently, however, a mid-sized micro-brewed root beer company purchased one of the old manufacturing plants (located just outside the city's downtown) and began operations. It employs 200 people and plans to double its workforce over the next two years. The company wants to capitalize on a recent resurgence in root beer "connoisseurs" by expanding the plant to include a tasting facility. And the company has expressed interest in opening a restaurant and root beer bar in the city's downtown. City leaders want to support the company's efforts. They view the company's investment in the city as a cornerstone for the city's resurgence.

In fact, the root beer company's recent investment in the city has sparked the interest of at least one developer. She has approached city officials about plans to help revitalize downtown. The developer intends to purchase several of the vacant buildings and refurbish them to attract a mix of small commercial entities, restaurants, bars, and residential tenants. Both the root beer company and the developer have requested (among other incentives) that the city invest in some infrastructure improvements and upgrades in the central downtown area to complement the private development. Specifically, the private entities would like the city to make road improvements, widen the sidewalks, install street lights, upgrade water and sewer lines, and demolish a city-owned structure to construct a parking lot.

Assuming that the city councilmembers are willing to make these public infrastructure investments, there are several available funding options, which fall into five general categories: (1) Current Revenues; (2) Savings; (3) Grants/Donations/Partnerships; (4) Special Levies; and (5) Borrowing Money. This is the second in a series of posts discussing these funding options. It focuses on "Special Levies"—describing two potential mechanisms whereby a unit may raise money from the property owners who most directly benefit from the capital project(s) financed with the raised

funds.



<http://ced.sog.unc.edu/wp-includes/js/tinymce/plugins/wordpress/img/trans.gif>

### Targeted Revenue Generation

The largest source of general fund revenue for both counties and municipalities is property tax proceeds. And the hallmark of property taxation is that all property owners (except those whose property is statutorily exempt) pay the tax(es), regardless of whether they directly benefit from the projects or services funded with the tax proceeds. Citizens entrust their local elected leaders to expend the proceeds for the general benefit of the community. Local elected leaders, however, often feel pressure to provide and fund an ever-increasing number of projects and services while, at the same time, maintaining or reducing the property tax levy. Because of this, units have come to rely on revenue generation mechanisms, such as user charges, that are targeted to the citizens or property owners who most directly benefit from specific services or projects. For example, in the past many municipalities funded solid waste services, including disposal facilities, convenience centers, and even curb-side pick-up, with property tax proceeds. Now these units typically assess user charges to cover some or all of the costs associated with these services. Other common user charges levied by

counties and municipalities are for water and wastewater utilities services, recreational and cultural activities, health and mental health services, ambulance services, parking, public transportation, stormwater, cemeteries, and airports. Units also rely on fee revenue to fund certain regulatory activities such as inspections and plan reviews. Generally user charges are feasible for any service that directly benefits individual “users,” is divisible into service units, and can be collected at a reasonable cost.

What about using user charges to fund capital projects or acquisitions? It is harder to divide most capital projects or assets into divisible units with defined beneficiaries. Most units attempt to apportion some of the capital costs associated with a particular service among the users of that service. The law allows for more targeted revenue generation through special levies—special assessments and service (tax) districts—to fund capital projects or capital assets.

### Special Assessments

A special assessment is levied against property to pay for public improvements that benefit that property. It is neither a user charge nor a tax but it has characteristics of both. Like a user charge, a special assessment is levied in some proportion to the benefit received by the assessed property. However, like a property tax, it is levied against property rather than persons and is a lien on each parcel of real property that is assessed. The lien may be foreclosed in the same manner as the foreclosure of property tax liens.

Local governments currently have two statutorily authorized methods to levy special assessments. The following chart summarizes the major characteristics of each method. For a detailed exposition of the authority, procedures, and limitations of each method click [here](#).

<p align="center"><b>Traditional Special Assessment Method</b></p> <p align="center"><b>G.S. 160A, Art. 10; G.S. 153A, Art. 9</b></p>	<p align="center"><b>Newer Special Assessment Method</b></p> <p align="center"><b>G.S. 160A, Art. 10A; G.S. 153A, Art. 9A</b></p>
<ul style="list-style-type: none"> <li>Limited statutory purposes</li> </ul>	<ul style="list-style-type: none"> <li>Expansive statutory purposes</li> </ul>
<ul style="list-style-type: none"> <li>Generally no petition requirement (except for street and sidewalk projects)</li> </ul>	<ul style="list-style-type: none"> <li>Petition requirement for all projects</li> </ul>
<ul style="list-style-type: none"> <li>Amount of assessment must be based on one or more statutory bases</li> </ul>	<ul style="list-style-type: none"> <li>Assessment method within discretion of governing board, but must relate to benefit to properties assessed</li> </ul>
<ul style="list-style-type: none"> <li>Unit must follow detailed statutory procedures before levying assessments (including at least 2 public hearings)</li> </ul>	<ul style="list-style-type: none"> <li>Unit must follow detailed statutory procedures before levying assessments (including at least 2 public hearings)</li> </ul>
<ul style="list-style-type: none"> <li>Unit may borrow money to front costs of project but may not pledge assessment revenue as security for loans</li> </ul>	<ul style="list-style-type: none"> <li>Unit may borrow money to front costs of project and may pledge assessments as security for loan</li> </ul>
<ul style="list-style-type: none"> <li>Unit must complete public improvement projects before assessments may be imposed</li> </ul>	<ul style="list-style-type: none"> <li>Unit may impose assessments before the projects are complete, based on estimated costs</li> </ul>



<ul style="list-style-type: none"> <li>Assessments often are paid in up to 10 yearly installments</li> </ul>	<ul style="list-style-type: none"> <li>Assessments may be paid in up to 30 yearly installments</li> </ul>
	<ul style="list-style-type: none"> <li>Authority EXPIRES July 2013</li> </ul>

***Benefits and Limitations of Traditional Assessment Method***

The traditional assessment method provides local units with a potentially important tool for funding capital projects. The ability to recoup some or all of the costs of a particular project from those property owners who most directly benefit from the project makes sense both financially and politically. Levying assessments also allows a local government to collect revenue from property owners who benefit from the capital projects but whose properties are exempt from property taxation. And using special assessments as a part of its revenue mix allows a governing board to direct property tax proceeds and other general fund revenues to services or to capital projects that benefit a broader subset of the unit's citizens.

Special assessments are not widely used by North Carolina local governments, though. This is due to a number of factors. For one, the process for levying assessments is onerous. (Click [here](#) for a detailed description of the assessment process.) Furthermore, the traditional assessment authority is limited to only a few categories of projects. Counties may levy special assessments to finance the following public improvements:

- Water systems
- Sewage collection and disposal
- Beach erosion control and flood and hurricane protection
- Watershed improvement, drainage, and water resources development projects
- Local cost of improvements made by the Department of Transportation to subdivision and residential streets outside municipalities
- Street light maintenance

Municipalities may levy assessments to finance the following public improvements:

- Streets
- Sidewalks
- Water systems
- Sewage collection and disposal systems
- Storm sewer and drainage systems
- Beach erosion control and flood and hurricane protection

Another significant limitation to the traditional method is that local units must front all of the costs of the project(s). Only after a project is complete may a unit levy the assessments, and assessments often are paid in installments over a number of years (up to ten). A unit must use unrestricted general fund revenue or borrowed funds to finance the project. Some local units have set up special assessment revolving funds, using yearly special assessment payments from former projects to fund new projects. It often takes several years to establish a sufficient revolving fund, though.

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### ***Benefits and Limitations of Newer Special Assessment Method***

Under the newer special assessment method, a local unit may levy assessments before the capital project is complete (based on estimated costs). And a unit may use the newer method to fund a broader array of capital projects. (Click [here](#) for a list of authorized projects.) The newer method also allows a local unit to pledge the special assessments as security for revenue bonds (special assessment bonds) issued to fund the capital projects. (To date no units have issued special assessment bonds in North Carolina.)

Under the newer method, however, a unit must first receive a petition signed by a majority of the owners of the properties to be assessed, representing at least 66 percent of the aggregate value of the properties. (The traditional method only requires a petition to levy assessments for street and sidewalk improvements.) The General Assembly enacted the newer special assessment method in 2008 as an alternative to impact fees. It effectively allows a local unit to levy assessments on property owned by a developer to fund public improvements that benefit the new development. Because assessments often are paid over a number of years (up to 30 under the newer method) this method allows a developer to shift the burden for paying for the public improvements to the eventual property owners.

### ***Basis of Assessment***

Under both assessment methods, the amount of each assessment must bear some relationship to the amount of benefit that accrues to the assessed property. The most common basis of assessment is front footage: each property is assessed on a uniform rate per foot of property that abuts on the project. Other common bases include the size of the area benefitted and the value added to the property because of the improvement. A unit also may set up benefit zones—setting different assessment rates in each zone according to degree of benefit.

### ***County and Municipal Service (Tax) Districts***

Another targeted revenue generation mechanism available to a local unit to fund capital projects is to establish one or more service (tax) districts. **G.S. 160A, Art. 23; G.S. 153A, Art. 16.** With one exception the state constitution requires that a local government's property tax rate(s) be uniform throughout the government. The constitution, however, authorizes the General Assembly to authorize a local government to define a part of the unit as a service district, to levy a property tax in the district additional to the county-wide or municipal-wide property tax(es), and to use the proceeds to provide services or fund capital projects in the district.

### ***Authorized Purposes for which Service District may be Created***

The General Assembly has authorized counties to define a service district for the following functions:

- Beach erosion and flood and hurricane protection
- Fire protection
- Recreation
- Sewage collection and disposal
- Solid waste collection and disposal
- Water supply and distribution
- Ambulance and rescue services
- Watershed improvement, drainage, and water resources development
- Cemeteries

And municipalities may establish a service district for any of the following functions:

- Beach erosion and flood and hurricane protection
- Downtown revitalization projects
- Urban area revitalization projects
- Transit-oriented development projects
- Drainage projects
- Sewage collection and disposal systems

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- Off-street parking facilities
  - Watershed improvement, drainage, and water resources development projects

### ***Taxing Authority in Service District***

A service district is in no way a separate unit of government. It is simply a geographic designation, a defined part of a county or municipality in which the government levies extra property taxes and provides extra services or undertakes capital projects that more directly benefit the properties within the district. Service district taxes are subject to the same exemptions and exclusions as the general property tax(es). (That is, property that is exempt from property taxes also is exempt from service district taxes.)

A unit's governing board sets the service district tax rate each year in its annual budget ordinance. The rate, combined with the unit's general property tax rate, may not exceed \$1.50 per \$100 assessed valuation of property in the district, unless the unit's voters have approved a higher general property tax rate.

All of the revenue generated by the service district tax must be used to provide the services or undertake the capital projects in the district. The moneys may not be diverted to other purposes. A unit is free to supplement the district tax revenue with general fund revenues.

### ***Process for Establishing a Service District***

A service district is defined by simple action of the governing board. No petition from district residents or property owners is required. A vote need not be held in the district in order to create it, although the governing board must hold a public hearing. The board, however, must find that the district needs the proposed services or projects "to a demonstrably greater extent" than the rest of the unit. A district generally must become effective at the beginning of a fiscal year, and the unit must "provide, maintain, or let contracts for" the services or projects within a reasonable time, not to exceed one year after the service district tax is levied. More information on service districts is available [here](#).

### ***Blight City Hypothetical***

Should Blight City consider using special levies to fund one or more of its public infrastructure projects? Obviously the answer to this question depends on a number of considerations, both legal and practical, but potentially both types of special levies could be used to fund all or a portion of the projects.

### ***Special Assessments***

Funding at least some of these projects with special assessments makes sense if the developers/property owners are willing to ultimately pay for the costs (or a portion of the costs) of the public infrastructure projects but need the government to front the capital. Of course the city would have to be able to front the capital. The city could borrow money to fund the projects. Under the newer special assessment method, the city could pledge the special assessments as security for the loan. And under either method it could do a "synthetic" special assessment financing, whereby it actually entered into an installment contract under **G.S. 160-20** to borrow the funds but used the stream of special assessment revenue to make its debt service payments.

### ***Service (Tax) District***

Because the proposed projects are in the city's downtown, the city also could establish a municipal service district for downtown revitalization. (Units typically refer to these as **Business Improvement Districts or BIDs**.) The unit could levy an additional property tax within the district to fund all or a portion of the projects. As a practical matter, the unit probably is limited to directly funding the smaller dollar projects (street lighting and maybe sidewalk improvements) with the district tax proceeds. The unit could borrow money to finance the larger projects and then use future years' district tax collections to make its debt service payments. However, the unit may not want to impose too high a tax on its downtown properties because this may discourage further development.



## Links

- [www.ncga.state.nc.us/Sessions/2013/Bills/Senate/PDF/S103v5.pdf](http://www.ncga.state.nc.us/Sessions/2013/Bills/Senate/PDF/S103v5.pdf)
- [www.sogpubs.unc.edu/electronicversions/pdfs/lfb40.pdf](http://www.sogpubs.unc.edu/electronicversions/pdfs/lfb40.pdf)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter\\_160A/Article\\_23.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_160A/Article_23.html)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter\\_153A/Article\\_16.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_153A/Article_16.html)
- [canons.sog.unc.edu/?p=4591](http://canons.sog.unc.edu/?p=4591)
- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_160A/GS\\_160A-20.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-20.html)
- [canons.sog.unc.edu/?p=2146](http://canons.sog.unc.edu/?p=2146)