Coates' Canons Blog: Special Assessments for Economic Development Projects

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Tonald Drump, a national real estate tycoon, is interested in developing an area in Frugal Village, NC. His proposal includes mixed-use residential and commercial development, located just outside the village's downtown. Drump is an experienced developer and knows that adequate public infrastructure is essential to a successful development project. In particular, he wants to ensure that his properties will be connected to the village's water and sewer systems. He also wants the streets within the development to be owned and maintained by the village. Finally, experience tells Drump that public sidewalks, street lights, and nearby parkland will enhance the marketability of his properties.

In the past, Drump has constructed the necessary infrastructure to support his development project and then deeded the infrastructure to the local government. Drump currently is a bit strapped for cash, though. He is trying to capitalize on the recent housing resurgence and is managing numerous development projects around the country. He lacks the financial capital to construct the infrastructure projects to support his development in Frugal Village. Drump approaches village officials to see if they are willing to complete (and fund) the public infrastructure projects. Village board members are excited about Drump's proposed development. They believe it is the key to the village's revitalization and future prosperity. The board members, however, live in Frugal Village for a reason. They are very reticent to spend the public's funds. They are particularly concerned about using general fund dollars to finance projects that directly benefit only a small portion of private property owners within the unit. Ideally, both Drump and village officials would like the public infrastructure projects to be completed without either party having to pay for them. Is that possible?

Believe it or not, it is possible. The village board could use its special assessment authority to impose the costs of the public infrastructure projects on the eventual property owners within the new development. And it could borrow money to front the costs of the projects and use the assessment payments to repay the loan. Thus, at least theoretically, the village could provide the public infrastructure necessary to incent Drump's development without having to use general fund (or enterprise fund) dollars to pay for the projects. Of course, the devil is always in the details….

What are Special Assessments?

Special assessments are levied against property to pay for public infrastructure projects that benefit that property. Like user charges, and unlike property taxes, special assessments are levied in some proportion to the benefit received by the assessed property. Unlike user charges, special assessments are levied against property rather than persons and are typically used to fund public improvements rather than services.

Currently, there are two different statutory methods for levying special assessments in North Carolina. Under both methods, a governing board defines an area within a unit that includes all properties that will directly benefit from a certain capital project. And under both methods a unit must follow a detailed statutory process to determine and impose the assessments. Only one of the methods, what I refer to as the newer assessment method, however, is specifically targeted to economic development projects (public infrastructure projects aimed at incentivizing private development).

Newer Assessment Method

During the 2008 and 2009 legislative sessions, the General Assembly bestowed the newer special assessment authority—entitled special assessments for critical infrastructure needs—on counties and municipalities to fund a wide range of capital projects. *See* **S.L. 2008-165**; **S.L. 2009-525**. (The legislature recently extended the authority for the newer assessment method to July 2015.) The authorized projects are almost exclusively government infrastructure projects—ranging from constructing and maintaining public roads to building public schools. (Click **here** and **here** for a

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complete list of authorized projects and a detailed description of both the traditional and newer special assessment authorities.)

The purpose of the newer authority, modeled on legislation from other states, is to help local units fund public infrastructure projects that benefit new development. It allows a unit to impose assessments, with payments spread out over a period of years, with the expectation that all or at least a majority of the assessments will be paid by the eventual property owners (instead of the developer or the local government). The unit can front the costs of the projects and recoup its investment over time with the yearly assessment payments. Alternatively, the unit may be able to borrow money, pledging the assessment revenue as security, and use the yearly assessment payments to meet its debt service obligations.

Conceptually, the newer special assessment authority functions much like an impact fee—it allows a unit to collect revenue from new development to pay for infrastructure costs that are necessitated by the new development. Unlike an impact fee, though, the newer assessment method imposes little to no costs on the developer. Most of the payments are collected once the development is completed (assuming, of course, that the development occurs as expected).

Assessment Process

In order to impose an assessment under the newer method to pay for a capital project, a unit must first receive a petition signed by a majority of the owners of property to be assessed, who also represent at least 66 percent of the value of the property to be assessed. In setting this fairly onerous petition requirement, the legislature envisioned that there would be a single owner, or, at most, a few owners, of the real property at the time the assessments are imposed (the developer(s)). The petition must include a description of the public infrastructure project, its estimated costs, and the percentage of that cost to be assessed. These details, as well as the basis of assessment, assessment repayment period, and any issues related to borrowing money to pay for the projects, typically are negotiated between the developer and the unit in advance.

Once a unit receives a petition, it must follow a detailed statutory process to impose the assessments. The process takes time, but, assuming the developer does not change his or her mind, it is relatively straight forward. The unit's governing board must:

- Adopt a preliminary assessment resolution
- Hold a public hearing on the preliminary assessment resolution, after providing proper notice
- Adopt the final assessment resolution
- Prepare a preliminary assessment roll
- Hold a public hearing on the preliminary assessment roll, after providing proper notice
- Confirm the assessment roll

For more detail on each of these steps, click **here**. Once the unit has confirmed the assessment roll, the assessments become a lien on the real properties that are assessed. The unit may demand full payment of the assessments within 30 days of publication of the confirmed assessment roll. More commonly, a unit will allow payment of the assessments, with interest, in up to 30 yearly installments.

Assessment-Backed Debt

One of the potential benefits of the newer assessment method is that it allows a unit to borrow money to front the costs of the project. The unit pledges the assessment revenue as security for the loan and uses the revenue to make its yearly debt service payments (special assessment-backed revenue bonds). This allows the unit to avoid committing any of the unit's funds to the project.

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Of course, there is a risk that the unit will not be able to collect all of the assessment revenue needed to meet the debt service obligations. The assessments are a lien on the properties assessed, and a unit has the same collection remedies available to collect delinquent assessments as it does delinquent property taxes. (The bonds likely will include a covenant requiring the unit to use all available collection remedies in the case of nonpayment by a property owner. This may pose some cost to the unit.) Despite the robust collection authority, the debt is relatively risky for investors. And the riskier the debt is, the more expensive the borrowing. Thus, using special assessment-backed revenue bonds often is a very expensive way to fund public infrastructure.

The Town of Hillsborough recently issued the first assessment-backed revenue bonds in North Carolina. The town borrowed $4.63 million at 7.75 percent interest for a 10 year term to fund public infrastructure associated with a private development project. According to the town's preliminary assessment resolution, the borrowed funds will be used to establish parks and open space, construct and improve water, wastewater and drainage facilities, construct and improve streets, roads, and rights-of-way in the assessment district, which encompasses a 210 acre area within the town. The town imposed assessments totaling $6.2 million on properties located in the assessment district, with payments allowed over a 10.5 year period. (For more information on the development project, click **here**.)

Issuing assessment-backed debt will not be feasible for every public infrastructure project that benefits new development. The State's Local Government Commission (LGC) must approve this type of debt and has published guidelines about minimum requirements and standards. A unit should work with the LGC's staff, financing advisors, bond counsel, and others to determine if this type of debt is appropriate for a particular project.

Links

- www.ncleg.net/gascripts/BillLookUp/BillLookUp.pl?Session=2007&BillID=H1770
- www.ncleg.net/Sessions/2009/Bills/Senate/PDF/S97v6.pdf
- sogpubs.unc.edu/electronicversions/pdfs/lfb40.pdf
- canons.sog.unc.edu/?p=7288
- www.ci.hillsborough.nc.us/dev-project/1927

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