

TAX EQUITY DEVICES AND TAX RELIEF PROGRAMS

This Chapter discusses alternative approaches used to address fiscal disparity – differences in revenue-raising capacity among local governments that are a product of the type of development that occurs. Two model statutes are presented: (1) regional tax-base sharing legislation, by which the growth in commercial, industrial, and high-value residential components of the regional property tax base is shared among local governments; and (2) a statute permitting a voluntary intergovernmental agreement among two or more units of local government to create a joint economic development zone. The contracting governments negotiate which public services and facilities are to be provided in the area that is to be included in the zone, and which tax and other revenues that result from commercial, industrial, and other development will be shared, and in what amounts or proportions.

The Chapter also contains model legislation for redevelopment, tax increment financing, and tax abatement. It includes a model law for designating agricultural districts, special areas where commercial agriculture is encouraged and protected. Land within such areas is then assessed at its use value in agriculture rather than its market or speculative value, a concept called “differential assessment.” The Chapter concludes with a research note on public school finance and its relationship to planning and development. The note was prepared by Prof. Michael Addonizio of Wayne State University.

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TAX EQUITY AND ITS RELATIONSHIP TO PLANNING

THE PROBLEM: DISPARITY IN LOCAL REVENUE-RAISING CAPACITY

Local governments throughout the country rely on local property taxes and, in some states, local income and sales taxes for revenues for their general operation. Therefore, it is understandable that the revenue-generating characteristics of land uses receive strong consideration in development decisions. In many circumstances, these characteristics are driving factors behind the approval process. Typically, in larger, older metropolitan areas with many local governments, reliance on a local (as opposed to a regional) tax base has produced patterns of interregional polarization and sprawling, inefficient land use.

Because of location and/or the forces of metropolitan change, such as state investment decisions on such facilities as highway interchanges, some local governments are winners and others are losers when government services are tied to a local tax base. For example, if two local governments in a region have exactly the same population, but one has extensive commercial, office, and industrial development, and the other residential development with some commercial uses, the latter government will have to increase property taxes to obtain the same amount of revenue as the former. The differences in the revenue-raising capacity of local governments in a region to support basic services is called “fiscal disparity.”

FISCAL ZONING

Prompted in part by fiscal concerns, local governments zone large tracts of land for commercial and industrial use, whether or not there is a presently demand for such uses. The practice of using the zoning power to achieve fiscal objectives rather than purely land-use objectives is known as “fiscal zoning.” Each local government believes it is a candidate for a large manufacturing facility, a regional shopping center, or a “big box” retail store that would enhance its financial position, either through revenues from the property tax or sales tax (especially on “big ticket” items like automobiles). Under the fiscal zoning approach, local governments will exclude any proposed development that might create a net financial burden and will encourage development that promises a net financial gain.¹

A serious direct effect of fiscal zoning, according to one federal study, has been the “spate of exclusionary practices relating to residential development.”² Fiscal zoning results in efforts to keep out lower income groups, and especially large families. Low- and moderate-income housing

¹See, e.g., Duane Windsor, *Fiscal Zoning in Suburban Communities* (Lexington, Mass.: Lexington Books, 1979); B. Rolleston, “Determinants of Restrictive Suburban Zoning: An Empirical Analysis,” *Journal of Urban Economics* 22, no. 1, (1987): 1-21; M. Wasylenko, “Evidence of Fiscal Differentials and Intrametropolitan Firm Relocation,” *Land Economics* 56 (1980): 339-49; and Robert Cervero, “Jobs-Housing Balancing and Regional Mobility,” *Journal of the American Planning Association* 55, no. 2 (1989): 136-150.

²National Commission on Urban Problems, *Building the American City* (Washington, D.C.: U.S.G.P.O, 1968), 19; see also Norman Williams, “The Three Systems of Land-Use Control,” *Rutgers L.Rev.* 25 (1970): 80-85 (discussion of impact of tax system on behavior of local governments in making land-use decisions).

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produces relatively lower tax revenues in comparison to the services it requires. Consequently, local governments resist setting aside land for such uses.³

MISMATCH BETWEEN SOCIAL NEEDS AND LOCAL TAX RESOURCES

“Fiscal disparity” is amplified through the process of metropolitan growth and change. The concentration of poverty in central cities and older suburbs destabilizes schools and neighborhoods. This concentration and destabilization are exacerbated by increases in crime, and result in the exodus of middle-class families and businesses. As social service needs accelerate and the obligation to repair and replace infrastructure intensifies, the property tax base and other fiscal resources to support such services erode.⁴ In a related pattern, growing middle-income communities, dominated by smaller homes and apartments, develop without sufficient property tax base to support schools and other public services. These fiscally stressed communities will become tomorrow's declining inner-ring suburbs.

Upper-income suburbs at the metropolitan fringes are frequently the beneficiary of a disproportionate share of regional infrastructure expenditures in sewers, waterlines, and major highways, including interchanges. These suburbs capture new high-value businesses and residences. As their property tax expands, and their housing markets exclude all but high-cost residences, social needs decline proportionally.⁵

ENCOURAGEMENT OF SPRAWL

As the waves of socioeconomic decline roll outward from the central cities and older suburbs, tides of middle-class homeowners sweep into outlying communities where they find long commutes to employment centers. These growing, outlying communities often use restricted, low-density single-family zoning to maintain a perceived quality of life. In so doing, they lock the region into low-density development patterns that require extensive automobile travel, are difficult to serve with mass transit, cause air pollution, and supplant forest and farmland in the process.⁶

³Id.

⁴For a summary of studies on fiscal disparity among local jurisdictions in the Chicago metropolitan area and Virginia, see R.S. Richman and M.H. Wilkinson, “Interlocal Revenue Sharing: Practice and Potential,” in *Ideas and Options* 1, no. 1 (1993): 3-6, published by the National League of Cities.

⁵See Myron Orfield, Jr., “Tax Base-Sharing to Reduce Fiscal Disparities,” in *Modernizing State Planning Statutes: The Growing SmartSM Working Papers, Vol. 1*, Planning Advisory Service Report No. 462/463 (Chicago: American Planning Association, March 1996), 167-170.

⁶Id.

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COMPETITION FOR TAX BASE AND INTERGOVERNMENTAL TENSION

Competition for tax base engenders intergovernmental conflict through pitched battles over annexations and bidding wars for businesses that have already chosen to locate in a region. Local governments that want to grow attempt to annex unincorporated lands from the surrounding county. Neighboring municipalities may often compete with each other for the same piece of land. In some parts of the country, this competition has depleted the tax base of another governmental unit, such as a township, as high-value land has been absorbed by the annexing municipal government. Developers benefit from this system as they can pit one local government against another by searching for the most favorable terms, including public subsidies and a relaxation of land-use standards. Tensions escalate among neighboring jurisdictions.⁷

The late Vermont Law School Professor Norman Williams, Jr., argued that statutory reform should concentrate on “[r]emoving the presently dominant concern with encouraging good ratables and discouraging bad ratables, so that public agencies can focus their attention clearly on other planning goals.”⁸ He added, “As long as we continue the present system of local real estate taxes to finance local public services, it will not really matter how many other innovative ideas are introduced; there will be no substantial change in how the system actually works.”⁹

APPROACHES TO ADDRESS METROPOLITAN TAX EQUITY

Two approaches have emerged over the past several decades to address metropolitan tax equity issues.

(1) **Tax-base-sharing legislation.** Two regions in the U.S. have specialized legislation that shares revenues from real property taxes: the Twin Cities metropolitan area in Minnesota and the Hackensack Meadowlands area in New Jersey.

Twin Cities. Regional tax-base sharing was implemented in the seven-county Twin Cities area in Minnesota with the passage of the Minnesota Fiscal Disparities Act in 1971.¹⁰ Under this program, each city contributes 40 percent of the growth of its commercial-industrial tax base acquired after 1971 to a regional pool. The value of properties in the regional pool is taxed at a weighted areawide rate. Funds from this areawide pool are distributed via an allocation formula that

⁷See, e.g., “Fresno County, Cities Fight Over Annexation,” *California Planning & Development Report* 4, no. 8 (August 1989): 1, 4; Laurie Reynolds, “Rethinking Municipal Annexation Laws,” *Urban Lawyer* 24, no. 2 (Spring 1992): 249; and Lori A. Burkhart, “Municipal Annexation: An Update on Issues and Controversies,” *Public Utilities Fortnightly* 127, no. 9 (May 1, 1991): 47.

⁸Norman Williams, Jr., “Halting the Race for ‘Good Ratables’ and Other Issues in Planning Legislation Reform,” in *Modernizing State Planning Statutes: The Growing SmartSM Working Papers, Vol. 1*, Planning Advisory Service Report No. 462/463 (Chicago: American Planning Association, March 1996), 58.

⁹Id.

¹⁰Minn. Stat. Ann. Ch. 473F (Metropolitan revenue distribution) (1994 and Cum. Supp. 1996).

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takes into account a local government's population and fiscal capacity (defined as per capita real property valuation). The Twin Cities system has been widely analyzed in the literature of law, planning, and economics.¹¹

According to Minnesota State Representative Myron Orfield, Jr., the present system has reduced tax-base disparities on a regional level from 50:1 to roughly 12:1. As of 1994, about \$393 million, or about 20 percent of the property tax base, was shared regionally.¹² The system has survived a court test on its constitutionality¹³ as well as an attempt to repeal it. It should be noted, for several reasons, that the Twin Cities system does not completely eliminate or solve the problem of fiscal disparity. For example, the system does not retroactively redistribute property tax revenues resulting from the existing tax base in 1971. In addition, the areawide pool of commercial and industrial property growth is not the result of an even split, but one in which 60 percent of the growth goes to the local government and the remainder to the pool. Also, the program does not generate wealth but instead redistributes it.¹⁴ Communities that have the least growth in tax base and the lowest per capita commercial and industrial values are the biggest beneficiaries from the

¹¹Studies or commentaries on the Twin Cities tax-base-sharing system include: Gary T. Johnson, "Tax Base Sharing and Fiscal Disparities: A Retrospective," *Municipal Management* (Fall 1984): 67-72; Katharine C. Lyall, "Regional Tax Base Sharing – Nature and Potential for Success" in Robert W. Burchell and David Listokin, *Cities Under Stress* (Piscataway, N.J.: Rutgers University Center for Urban Policy Research, 1981), 493-500; Katharine C. Lyall, "Tax-Base Sharing: A Fiscal Aid Toward More Rational Land Use Planning," *Journal of the American Institute of Planners* 41, no. 2 (1975): 90-100; Note, "Minnesota's Metropolitan Fiscal Disparities Act – An Experiment in Tax Base Sharing," *Minnesota L. Rev.* 59 (1975): 927-963; Andrew Reschovsky and Eugene Knaff, "Tax Base Sharing: An Assessment of the Minnesota Experience," *Journal of the American Institute of Planners*. 43, no. 4 (1977): 361-370; Charles R. Weaver, "The Minnesota Approach to Solving Urban Fiscal Disparity," *State Government* XLV (Spring 1972): 100-105; and John W. Windhorst, "The Minnesota Fiscal Disparities Law," *Land Use Law and Zoning Digest* 28, no. 4 (1976): 7-12. See also W. Patrick Beaton, "Regional Tax Base Sharing: Problems in the Distribution Function," in Robert W. Burchell and David Listokin, *Cities Under Stress* (Piscataway, N.J.: Rutgers University Center for Urban Policy Research, 1981), 501-526; D.A. Gilbert, "Property Tax Base Sharing: An Answer to Central City Fiscal Problems," *Social Science Quarterly* 59, no. 4 (1979): 681-689; and Walter Vogt, "Tax Base Sharing: Implications from San Diego County," *Journal of the American Planning Association* 45, no. 2 (1979): 134-142.

¹²Myron Orfield, Jr., "Tax Base Sharing to Reduce Fiscal Disparities" in *Modernizing State Planning Statutes: The Growing SmartSM Working Papers, Vol. 1*, Planning Advisory Service Report No. 462/463 (Chicago: American Planning Association, March 1996), 169.

¹³*Burnsville v. Onischuk*, 301 Minn. 137, 22 N.W.2d 523 (1974), cert. denied, 420 U.S. 916 (1974).

¹⁴The distribution formula itself has been the subject of some academic criticism on the grounds that if it were modified to take into account size of the population below the poverty level, the existence of special needs populations, and factors such as the age of the housing stock, the allocation to individual communities would be based on a more precise definition of need. See Gary T. Johnson, "Tax Base Sharing and Fiscal Disparities: A Retrospective," *Municipal Management* (Fall 1984): 70, citing Andrew Reschovsky and Eugene Knaff, "Tax Base Sharing: An Assessment of the Minnesota Experience," *Journal of the American Institute of Planners* 43, no. 4 (1977): 67; and D.A. Gilbert, "Property Tax Base Sharing: An Answer to Central City Fiscal Problems," *Social Science Quarterly* 59, no. 4 (1979): 684.

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program. Communities with higher-than-average per capita fiscal capacity generally receive a smaller share than they have contributed.¹⁵

Hackensack Meadowlands, N.J. Special tax-base-sharing legislation was adopted by the New Jersey legislature in 1968 for the Hackensack Meadowlands District, located near the New York metropolitan region. The Meadowlands is composed primarily of wetlands and extensive areas of marshland adjacent to intensive development. Through the adoption and administration of a comprehensive management plan, the Hackensack Meadowlands Development Commission oversees development in the district.¹⁶

Fourteen communities that have property partially included within the district participate in the intermunicipal revenue-sharing plan. The plan's intent was to compensate those municipalities for the fiscal impact of land-use decisions made by the commission. Each municipality contributes to an "intermunicipal account" in an amount equal to a percentage of increases in assessed valuation of property within the district, starting from the base year of 1970. The annual contribution is based on determinations of: the increase of true value of real property in the district since the base year; the total effective tax rate applicable to that property; and the percentage of the tax rate attributable to the municipality after the county portion is extracted.¹⁷ Payments from the account are made on the basis of a municipality's portion of the total land area

Can Tax-Base Sharing be Duplicated Elsewhere?

Here's what Minnesota State Representative Myron Orfield, Jr., says about potential support for regional tax-base sharing elsewhere in the U.S.:

There is a broadly shared belief that tax-base sharing came out of some cosmic consensualism in progressive Minnesota that cannot be duplicated elsewhere in the nation. This is not true.

Tax-base sharing in Minnesota has always been controversial. Many suburban governments at first feared loss of tax base and local control. But wise leaders realized the high degree to which property wealth was concentrated and developed computer runs that showed the projected amount of tax base cities would actually gain.

Most of the inner and developing middle-class suburbs were potential recipients. When these suburbs realized that tax-base sharing was likely to increase substantially their tax base and stabilize their future fiscal situation, they became supporters. As one legislator put it: "Before the runs, tax-base sharing was communism. Afterwards, it was 'pretty good policy.'"

¹⁵R.S. Richman and M.H. Wilkinson, "Interlocal Revenue Sharing: Practice and Potential," 9.

¹⁶The legislation authorizing the Hackensack Meadowlands Commission appears at N.J.S.A. §§13:17-60 to 13:17-76.

¹⁷*Id.*, §13-17-67.

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in the district.¹⁸ Municipalities may also receive compensation from the fund when land is removed from the local tax rolls for a public purpose (e.g., a park) or when new development stimulates growth in school enrollment to compensate for increased educational costs.¹⁹ One assessment of the program described its impact as follows:

The New Jersey tax-sharing program appears to have evolved essentially as an intergovernmental revenue transfer mechanism. In 1991, total contributions and disbursements under the program equaled \$4.67 million for all participating localities. Exclusive of retroactive adjustments for prior years, only two jurisdictions made net contribution to the intermunicipal account in excess of \$1 million – Secaucus (\$2.81 million) and North Bergen (\$1.42 million) – while only one received a payment of more than that amount from the fund – Kearny (\$2.72 million). Of the remaining localities, one was a net contributor or recipient of more than \$500 thousand.²⁰

(2) **Interlocal revenue-sharing agreements.** A number of states have special legislation authorizing local governments to enter into interlocal agreements to share revenues from development. These are intended to encourage intergovernmental cooperation and forestall attempts by cities to annex unincorporated territory. The legislation may authorize sharing of various types of tax revenues, including property, local income, and local sales taxes.

Virginia. One of the best known interlocal revenue-sharing statutes is Virginia’s. Under Chapter 26.1:1 of the Code of Virginia, counties, cities, and towns may enter into voluntary agreements to settle annexation and related issues. The statute provides that the agreement may include:

fiscal arrangements, land use arrangements, zoning arrangements, subdivision arrangements and arrangements for infrastructure, revenue and economic growth sharing, dedication of all or any portion of tax revenues to a revenue and growth sharing account, boundary line adjustments, acquisition of real property and buildings, and the joint exercise or delegation of powers as well as the modification or waiver of specific annexation, transition or immunity rights as determined by the local governing body.²¹

The statute requires that the agreements be reviewed by the state’s commission on local government, which must hold a public hearing on it, and then make an advisory recommendation to a special court and to the affected local governments. Prior to court action on the agreement, the affected local governments must each hold a public hearing and adopt by ordinance the original or modified agreement. The court may then affirm or reject the agreement. Upon affirmation of the

¹⁸The statute calls this an “apportionment payment.” Id. §13:17-72.

¹⁹The statute provides for “guarantee payments” to compensate for exempt property and for “service payments” to schools. Id., §§13:17-68,- 70.

²⁰R.S. Richman and M.H. Wilkinson, “Interlocal Revenue Sharing: Practice and Potential,” 11.

²¹Code of Va. §15-1-1167.1.2 (1994).

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agreement by the court, it becomes binding on the future governing bodies of participating jurisdictions.²²

A number of cities and counties in Virginia have used the voluntary agreement, including the City of Charlottesville and surrounding Albermarle County, the City of Lexington and surrounding Rockbridge County, the City of Franklin and surrounding Southampton County, and the City of Franklin and Isle of Wight County.²³ Under the Charlottesville/Albermarle agreement, for example, the city and the county agreed to share property tax revenue in lieu of a proposed annexation. In a 1982 agreement, the city and the county established a revenue-sharing fund to which both entities contribute. The contributions to the fund were negotiated, with each jurisdiction's contribution to the fund being 37 cents per \$100 of assessed valuation.²⁴

Under the agreement, the city decided not to initiate annexation procedures against the county and not to support any annexations initiated by private property owners. Moreover, the agreement provides:

[E]xcept for ad valorem property taxes, taxes on restaurant meals, transient lodgings or admission to public places or events and other general or selective sales or excise taxes, neither jurisdiction will . . . impose or increase any tax that would affect residents of the other jurisdiction if the other jurisdiction is not legally empowered to enact that tax at the same rate and in the same manner.²⁵

²²Id., §§15-1-1167.1.3-6 (1994).

²³R.S. Richman and M.H. Wilkinson, "Interlocal Revenue Sharing: Practice and Potential," 11-23; see also Gary T. Johnson, "Tax-Sharing as an Alternative to Annexation: A Virginia Case Study," *Urban Law and Policy* 7 (1985): 243-254 (1985) (discussion of City of Charlottesville/Albermarle County agreement).

²⁴According to an analysis by Virginia Commonwealth University Professor Gary T. Johnson, the agreement provided for five distinct interrelated steps to distribute the fund:

First, population indices are calculated by dividing each locality's population by the combined populations of both jurisdictions. Second, "relative tax effort" indices are calculated by dividing each jurisdiction's true real property tax rate by the combined true real property tax rates of the two communities. Third, a composite index for each community is computed by averaging these two indices. Fourth, each jurisdiction's share of the fund is calculated by multiplying the community's composite index by the fund itself. Finally, net transfers of wealth are obtained by subtracting each locality's share of the fund from [its] contributions to it.

Id., 248.

²⁵Id., citing "Annexation and Revenue Sharing Agreement of February 17, 1982," Section III (Charlottesville, Va. 1982), 6.

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Ohio. Ohio statutes authorize municipalities to establish “joint economic development zones”²⁶ and municipalities and townships to establish “joint economic development districts.”²⁷ A number of Ohio jurisdictions have taken advantage of the program, including the cities of Barberton and Norton,²⁸ the City of Springfield and Green Township in Clark County (for property surrounding a municipally owned airpark), and the City of Akron and Coventry, Springfield, and Copley Townships in Summit County.²⁹ The advantage of the municipal/township joint economic development district is that it allows the imposition of an income tax on individuals living or working in the district and on the net profits of businesses in the district. This is a power that, in Ohio, is otherwise granted only to municipalities and not to townships or counties that have jurisdiction over unincorporated areas. The district’s board of directors, composed of elected members of the legislative bodies and the elected chief executive officers of the contracting bodies, levy the income tax, subject to a vote by the electors of the district.

Montgomery County, Ohio. Although not the creature of special state legislation, a voluntary effort has been instituted for communities in the Montgomery County (Dayton), Ohio, Economic Development/Governmental Equity (ED/GE). The program consists of two separate, related funds administered by the county. The Economic Development (ED) Fund distributes approximately \$5 million per year of county sales tax revenue to finance economic development projects submitted to the county.

Approaches to Ensure Tax Equity

<i>Approach</i>	<i>Use When There Is</i>
Regional Tax-Base Sharing	Widespread agreement in a region that communities need to work together to support sensible development patterns and reduce fiscal disparity
Intergovernmental Revenue-Sharing Agreements	A desire among local governments for flexibility to negotiate special agreements with terms and conditions that are specific to their own sets of problems, interests, and capabilities for a subsection of the region

²⁶Ohio Rev. Code §715.69 (1995).

²⁷Ohio Rev. Code §§715.70 to 715.71 (1995).

²⁸R.S. Richman and M.H. Wilkinson, “Interlocal Revenue Sharing: Practice and Potential,” 24.

²⁹Office of Strategic Research, Ohio Department of Development, *Joint Economic Development Districts* (Columbus, Oh.: ODOD, December 1995). This report includes executive summaries of the Akron joint economic development district contracts.

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Monies from the ED fund are awarded on a competitive basis through the application of selection criteria to individual projects.

Annually, through the Governmental Equity (GE) Fund, a portion of increased property and income taxes collected as a result of economic growth of participating cities, villages, and townships in the county, is also shared with participants in the program. The distribution formula is made to each jurisdiction, based on its share of the total population of all participating jurisdictions. The two funds are intended to promote local and regional economic development objectives. Local governments that participate in the program sign a 10-year agreement with the county.³⁰

Other states. Colorado, Kentucky, and Michigan have legislation authorizing voluntary revenue-sharing agreements; a number of local governments in those states have taken advantage of these statutes.³¹ Intergovernmental agreements can offer local governments extraordinary flexibility in devising revenue-sharing arrangements. Like tax-base sharing, they will not completely remedy the problem of fiscal disparity and winner-take-all competition for tax base. However, they can lessen these problems and reduce tension among governmental units, especially those problems related to annexation. Still, they require diplomacy in their negotiation and a very good technical grasp of the economic, infrastructure, and planning issues affecting the jurisdictions entering into the agreement.

REGIONAL [METROPOLITAN] TAX-BASE SHARING

Commentary: Regional [Metropolitan] Tax-Base Sharing

The following model legislation authorizes regional or metropolitan property tax base sharing. In adapting the model, a state legislature has several policy choices:

³⁰Montgomery County, Ohio, *Summary of 1995 Economic Development/Governmental Equity (ED/GE) Program* (Dayton, Oh.: Montgomery County, 1995); William J. Pammer, Jr., and Jack L. Dustin, "Fostering Economic Development through County Tax Sharing," *State and Local Government Review* 25, no. 1 (Winter 1993): 57-69 (this article includes an extensive discussion of the development of the contribution and distribution formulas); Ann Schenking, "Economic Development/Governmental Equity Program: Providing a Competitive Edge for Montgomery County, Ohio," *Economic Development Commentary* 19, no. 3 (Fall 1995): 18-24; and Jack L. Dustin, *Cooperative Communities – Competitive Communities: The Role of Interlocal Tax Revenue Sharing*, Ohio Task Force on Competitiveness and Cooperation Monograph Series (Dayton, Ohio: Wright State University Center for Urban and Public Affairs, 1994).

³¹Colo. Rev. Stat. Ann. §29-1-203 (West 1989); K.R.S. §§ 65.210 to 65.300 (1995); K.R.S. 65.245 specifically authorizes cooperative interlocal agreements for the sharing of revenues; and Mich. Comp. Laws. §§ 124.501 to 124.512 (1991). Mich. Comp. Laws §124.505 authorizes interlocal agreements for sharing revenues and for the benefit of local government units; see also R.S. Richman and M.H. Wilkinson, "Interlocal Revenue Sharing: Practice and Potential," 26-27 (discussing an interlocal revenue-sharing and development regulation agreement between the cities of Westminster and Thornton, Colorado, and a joint economic development agreement between the cities of Detroit and Hamtramck, Michigan).

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- ◆ A state legislature can choose among two tax bases to share, selecting either or both the commercial-industrial tax base, which is the base used in the Minnesota Fiscal Disparities Act, or the excess residential property tax base. This latter tax base is that portion of the single-family residential property valued in excess of an amount specified in the statute (say, \$150,000 or \$200,000) or tied to a multiplier (say, 150 to 200 percent) of the average value of a single-family residence in the region. Use of the excess residential property tax base would redistribute revenues from those communities that have homes that are valued significantly more than typical homes in the region. The statutory floor on high-value, single-family property, when the amount is specified in the statute, must periodically be changed to reflect the impact of inflation on the region.
- ◆ A state legislature can choose among a range of percentages for the commercial-industrial tax base. Under the formula, a percentage of the growth in the commercial-industrial tax base is shared, starting from a base year to the current year. In the Twin Cities model, 40 percent of the growth goes into an areawide pool. In the following model, in Section 14-106, several alternate percentages (25, 40, or 50 percent) can be applied to determine which proportion is allocated for the areawide pool.
- ◆ A state legislature can choose from two methods for calculating the fiscal capacity of a local governmental unit: (1) the total property valuation of the unit divided by the total population; or (2) the total property valuation plus the total personal income received by residents of the unit divided by the total population of the unit.

Determining each community's contribution and share of the areawide tax base is one of the most difficult aspects of the model legislation to understand. Below are examples of typical calculations that demonstrate how contributions and shares are calculated.

CONTRIBUTIONS

Commercial-industrial property. Assume that the regional tax base is 50 percent of the growth of commercial and industrial property valuation from a base year to a current year. Between the base year and year 5 of the program, the equalized assessed commercial-industrial valuation in a community grows by \$5,000,000. Under the formula, 50 percent (or \$2,500,000) of this value would represent that portion of the community's commercial-industrial tax base that would constitute the community's portion of the areawide tax base. If there were 25 communities in the region, the total commercial-industrial areawide tax base would be the product of each community's portion of the areawide tax base, times 25. (See Sections 14-105 and 14-106 of the model below.) If a community had no growth in its commercial-industrial property tax base, it would contribute nothing to the areawide tax base pool.

Excess residential value. If a community of 1,500 residences (both multi- and single-family) has 200 single-family homes with an average value of \$250,000 each, and the floor on the excess residential property tax base is \$200,000, \$10 million (200 x (\$250,000-\$200,000)) would be subject

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to sharing (this assumes the added increment in residential value over the floor of \$200,000 is all growth from a base year). The “excess residential contribution percentage” is determined by dividing the amount subject to sharing (i.e., \$10 million) by \$50 million (i.e., the total average value of single-family homes in the community – 200 x \$250,000), or 20 percent. (See Section 14-106, Computation of Areawide Tax Base.) If a community had no homes valued in excess of \$200,000 apiece, it would contribute nothing to the areawide tax base.

Applicable Tax Rate. Under the model, the community’s tax rate is calculated from the dollar amount to be levied on the taxable value of that community. The community’s tax rate on the shared tax base (commercial-industrial, excess residential, or both) will be the weighted average of all units of government in the region. (See Section 14-109, Levies and Mill Rates: Local and Areawide.) Consequently, a piece of property that is commercial or industrial land use will have two tax rates: (1) a local tax rate applied to the part of its value that remains local; and (2) an areawide tax rate applied to the part of its value that makes up the areawide tax base. Similarly, a single-family house whose value is in excess of the statutory floor will have two tax rates applied to the property: (1) a local rate on the portion at or below the statutory floor; and (2) an areawide rate for all value in excess of the statutory floor.

DISTRIBUTION OF REVENUES FROM AREAWIDE BASE

In order to compute each community’s share of revenues from the areawide tax base, two calculations are made (see Section 14-107, Distribution of Areawide Tax Base).

Calculation of a distribution index. A local governmental unit’s distribution index is calculated as follows:

$$\text{Unit Distribution Index} = \text{Population of Unit} \times (\text{Average Fiscal Capacity} / \text{Fiscal Capacity of Unit})$$

“Fiscal capacity” is either the total property valuation of the community divided by its population, or the total property valuation, plus the sum of income received by residents of the unit, divided by the population of the unit. “Average fiscal capacity” is the sum of property tax bases (and of personal income of all qualifying units, where this is included), divided by the sum of their populations, as of a date in the same year.

Calculation of distribution value. To determine the share (“distribution value”) of the areawide tax base, the areawide tax base is multiplied by the proportion of each local governmental unit’s distribution index over the sum of the indices for all units. The resulting figure is the areawide tax base for any give year that is attributable to any particular unit.

$$\text{Unit Distribution Value} = \text{Areawide Tax Base} \times (\text{Unit Distribution Index} / \text{Sum of Distribution Indices for all Units})$$

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SAMPLE CALCULATION³²

To understand how the formulas work, it is useful to plug figures into the sample calculations. Using Communities X, Y, and Z, which are “qualifying local units” eligible to participate in the tax base sharing program under the model legislation, the following examples illustrate how the formulas operate with varying per capita valuation or fiscal capacity (with or without personal income included) and when the population differs. The areawide tax base described below can include the excess residential value growth component as well as the commercial-industrial growth component.

Community	Population	Per Capita Valuation/Fiscal Capacity
X (low population, high valuation)	20,000	\$200,000
Y (low population, low valuation)	20,000	\$20,000
Z (high population, low valuation)	40,000	\$20,000

Areawide tax base = \$1,000,000

Areawide population = 100,000

Total valuation for all communities = \$100,000,000

Sum of distribution indices for all communities = 200,000,000

Community X

$$\text{Distribution index} = 20,000 \times ((\$100,000,000/100,000)/(\$200,000/20,000)) = 2,000,000$$

$$\text{Areawide tax base} = \$1,000,000 \times (2,000,000/200,000,000) = \$10,000 \text{ (the share of the areawide tax base for Community X)}$$

Community Y

$$\text{Distribution index} = 20,000 \times ((\$100,000,000/100,000)/(\$20,000/20,000)) = 20,000,000$$

³²This example is adapted from Mary E. Brooks, “Minnesota’s Fiscal Disparities Bill,” *PAS Memo* No. 9 (Chicago, Ill.: American Society of Planning Officials, 1972), 3.

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Areawide tax base = $\$1,000,000 \times (20,000,000/200,000,000) = \$100,000$ (the share of the areawide tax base for Community Y)

Community Z

Distribution index = $40,000 \times ((\$100,000,000/100,000)/(\$20,000/40,000)) = 80,000,000$

Areawide tax base = $\$1,000,000 \times (80,000,000/200,000,000) = \$400,000$ (the share of the areawide tax base for Community Z)

14-101 Findings and Purpose³³

- (1) The [legislature] finds that [certain of the] metropolitan areas of the state are confronted with increasing social and economic polarization and wasteful sprawling development patterns. In these areas:
 - (a) poverty concentrates and social and economic needs grow in the central cities and older suburban communities, with older suburban areas having less resistance to these trends than central cities;
 - (b) certain suburbs are developing at the edges of regions but with insufficient property tax bases to support local services;
 - (c) in these central cities, older suburbs, and developing suburban areas with low tax bases, where the majority of the region's social needs are located, there is a comparatively small per capita property tax base that is slow growing, stagnant, or declining;
 - (d) other developing suburbs constitute a special sector of the region that dominates regional economic growth, has highly restrictive housing markets, receives a disproportionate share of local infrastructure investment, has an insufficient number of workers for local jobs, and experiences local congestion problems that cannot be solved by adding new highway capacity;
 - (e) in this special sector, the large per capita property tax base grows very rapidly in the face of slow-growing, stable, or declining social needs in the sector; and

³³The model legislation in Section 14-101 *et seq.* was drafted by the Hon. Myron Orfield, Jr., a Minneapolis attorney who is a state representative in Minnesota. It is based on the Twin Cities tax-base-sharing statute as well as a model published by the U.S. Advisory Commission on Intergovernment Relations (ACIR), "Metropolitan Tax Base Act," Bill No. 3.108 (Washington, D.C.: ACIR, 1984).

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- (f) as a consequence, the region polarizes socially and economically, with older communities experiencing decline through flight of their population base, and the competition for property tax base inducing growing fiscal inequity and sprawling wasteful development patterns.
- (2) The [legislature] further finds that tax-base sharing:
 - (a) creates greater equity among communities;
 - (b) breaks the intensifying mismatch between local needs and communities' tax bases;
 - (c) removes local economic incentives underlying exclusive fiscal zoning;
 - (d) reduces the interregional competition for a tax base; and
 - (e) facilitates regional land-use planning efforts.

14-102 Definitions

- (1) “**Administering Fiscal Officer**” means the [state director of finance *or* fiscal officer of a county selected pursuant to Section [14-103] below *or* fiscal officer chosen by the governing board of the council of governments or other regional body comprising the principal units of general government in the area].
- (2) “**Area**” means a metropolitan area as defined by the most recent publication of the United States Bureau of the Census and the Office of Management and Budget [*or such other definition as the state may prefer*].
- (3) “**Average Fiscal Capacity**” means the sum of the property tax bases [and of the personal income bases] of all qualifying local units in the area as of a particular date, divided by the sum of their populations, as of a date in the same year.
- (4) “**Commercial-Industrial Property**” means the categories of property set forth in [*cite statute defining this class of property*], excluding that portion of such property which: (i) constitutes the tax base for a tax increment pledged pursuant to Section [14-302], certification of which was requested prior to the effective date of this Act, to the extent and so long as such tax increment is so pledged; (ii) may, by law, constitute the tax base for tax revenues set aside and paid over for credit to a sinking fund pursuant to the direction of the governing body of a unit of local government in accordance with [*statute providing for local debt retirement through a sinking fund procedure*], to the extent that such revenues are so treated in any year; or (iii) is exempt from taxation pursuant to [*cite statute, if any, mandating or authorizing the exemption of any types of commercial-industrial or ad valorem taxes*]. [*Insert any other additions to or exclusions from the statutory definition of commercial-industrial property that are desired for purposes of this Act*].

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- (5) “**Component Local Unit**” means any [county, municipality, village, town, township], school district, or other special service district authorized to impose *ad valorem* taxes on commercial, industrial, or residential property, located wholly or partly within the area.
- (6) “**Contribution Value**” means the value of that portion of the commercial-industrial and the excess residential property tax base transferred from local to areawide taxability.
- (7) “**County or Municipal Fiscal Officer**” means the principal financial official of a county or municipal government, such as an auditor, treasurer, or director of finance.
- (8) “**Distribution Value**” means the value to a qualifying local unit of its share of the areawide property tax base.
- (9) “**Excess Residential Property**” means that portion of a component local unit’s tax base that exists in the portion of [single-family homestead] residential property valued in excess of [\$150,000 or \$200,000].³⁴
- (10) “**Fiscal Capacity**” of a qualifying local unit means the [sum of income received by the residents of the unit and the] property tax base of such unit divided by the population of the unit.
- (11) “**Income**” means the total money from all sources as reported by the U.S. Department of Commerce Bureau of the Census [*or the latest official state estimate of income*] for general statistical purposes.
- (12) “**Levy**” means the amount certified to the county or municipal fiscal officer as being necessary to be derived from property taxation in a forthcoming year or which has been derived from that source in preceding years.
- (13) “**Qualifying Local Unit**” means any component [county, municipality, town, township, or village] with a population of [1,000 or more] that is to share in that portion of the tax base transferred from local to areawide taxability.³⁵

³⁴This figure can instead be tied to some value that is a multiplier of the average value of a single-family home in the region or metropolitan area. For example, if the average value of a single-family home in a given tax year is \$100,000, the definition of “excess residential property” could be 150 percent (\$150,000) or 200 percent (\$200,000) of the average value. Using this approach would require that the average value be calculated each year but would eliminate the need to change the amount in the statute.

³⁵Qualifying local units should be chosen so that they will cover the entire area, with no overlap, and where standard demographic information, such as population, is readily available for each unit. Generally, counties or municipalities could be used, but not both. If municipalities are used, but there are unincorporated places within the area, those places should also be treated as qualifying units. Where a population threshold is used for qualifying local units, it would be equivalent to assigning those units that fall below the threshold a contribution value and distribution value equal to zero.

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- (14) “**Population**” means the most recent estimate of the population of qualifying local units in the area made by the [U.S. Census Bureau *or state agency or the regional planning or other agency that embraces the particular metropolitan area*].
- (15) “**Property Tax Base**” means the full value of taxable property as equalized for state tax purposes by the [department of revenue *or other state agency charged with equalizing property tax assessments among local governments*].

14-103 Administering Fiscal Officer

- (1) The director of the state [department of finance *or other appropriate state agency*] shall serve as the administering fiscal officer and shall discharge the duties imposed upon him or her by this Act].

[or]

- (1) On or before [date following the effective date of this Act] and every [2] years thereafter, the fiscal officers of the counties and of the [municipalities] of [25,000] population and over within the area shall meet at the call of the fiscal officer of [county in which the largest city of the area is located] and shall elect from among their number a fiscal officer to serve as the administering fiscal officer for the tax base sharing plan [for a period of 2 years *or until such time as a successor is chosen in the same manner as just described*]. If a majority is unable to agree on a person to serve as administering fiscal officer, the state [director of finance] shall appoint such a person from among the group of county and municipal fiscal officers in the area. If the administering fiscal officer ceases to serve as a county or municipal fiscal officer within the area [during the term for which he or she was elected or appointed], a successor shall be chosen in the same manner as is provided for the original selection [to serve for the unexpired term]].

- (2) To perform the functions imposed by this Act, the administering fiscal officer shall use the staff and facilities of the fiscal office of the county or municipality in which he or she serves. The administering fiscal officer’s county or municipality shall be reimbursed for the marginal expenses incurred hereunder by the administering fiscal officer and staff through a contribution from each of the other qualifying local units in the area in an amount that bears the same proportion to the total expense as the population of the respective other units bears to the total population of the area. The administering fiscal officer shall annually, on or before [date], certify the amounts of total expenses for the preceding calendar year and the share of each unit, to [the [treasurer] of] each other unit. Payment shall be made by [the [treasurer] of] each unit to the unit incurring the expenses on or before the succeeding [date].

[or]

- (2) [In the event that the state fiscal agency administers and maintains the accounts for the tax-base sharing plan *or for a plan in each of two or more metropolitan areas, insert a*

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provision here for a pro-rata contribution or other arrangement to cover operating expenses considered necessary.]

14-104 Assessed Valuation: Base Year and Subsequent Years

- (1) On or before [*date consistent with beginning date of the tax-base-sharing program*], each qualifying local unit's [county assessor] shall separately determine and certify to the administering fiscal officer the [equalized] assessed valuation for the year [19-- or 20--] of commercial-industrial and of excess residential property subject to taxation within the unit. The administering fiscal officer shall request of the [state department of revenue or state equalization agency] a similar tabulation of state-equalized assessments of such property and shall provide to the governing body of each qualifying local unit and make available to the public a tabulation of [state-equalized] valuations of commercial-industrial and excess residential property for the area as a whole. The initial year covered by the foregoing valuations shall be the base year against which subsequent changes in commercial-industrial and excess residential property tax bases shall be calculated.
- (2) On or before [*month, day*] of each subsequent year, each qualifying local unit's [county assessor] shall determine, certify, and provide to the administering fiscal officer the assessed valuation of commercial-industrial and excess residential property in the form described in paragraph (1) above, and the administering fiscal officer shall obtain, tabulate, and publish in the same manner and composition as above the [state-equalized] valuations of such property.

14-105 Increases in Assessed Valuation of Commercial-Industrial Property; Computation of Excess Residential Property

- (1) On or before [2 years following the effective date of this Act], the county fiscal officer of each qualifying local unit shall determine the amount, if any, by which the equalized assessed valuation determined pursuant to Section [14-104] above, of commercial-industrial property subject to taxation within each unit in his or her county exceeds the assessed valuation in [*insert base year*] of commercial-industrial property subject to taxation within that county. On or before [2 years following the effective date of this Act], the county fiscal officer of each qualifying local unit shall determine the amount, if any, by which the equalized assessed valuation determined pursuant to Section [14-104] above, of excess residential property subject to taxation within each unit in his or her county exceeds the assessed valuation in [*insert base year*] of excess residential property subject to taxation within that county.
- (2) The increases in assessed value determined by this Section shall be reduced by the amount of any decreases in the assessed valuation of commercial-industrial and excess residential property resulting from any court decisions, court-related stipulation agreements, or abatements for a prior year, and only the amount of such decreases made during the 12-month period ending on [*date*] of the current assessment year, where such decreases, if originally reflected in the determination of a prior year's [equalized] assessed valuation

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under Section [14-104], would have resulted in a smaller base contribution from the component local unit in that year. An adjustment for such decreases shall be made only if the unit made a contribution in a prior year based on the higher valuation of the commercial-industrial and excess residential property.

14-106 Computation of Areawide Tax Base

- (1) Each county fiscal officer shall certify the equalized assessed valuations and increase thereof, pursuant to Sections [14-103] and [14-104] above, separately for both commercial-industrial and excess residential property to the administering fiscal officer on or before [date] of each year. The administering fiscal officer shall multiply the commercial-industrial component certified pursuant to Section [14-105]] by [.25 or .40 or .50], and shall add the resulting product to the excess residential growth component certified pursuant to Section [14-105]. The resulting amount shall be known as the “areawide tax base for (year).”
- (2) For each qualifying local unit, a “commercial-industrial contribution percentage” shall be computed as the commercial-industrial value determined in paragraph (1) above divided by the total commercial-industrial value of the qualifying local unit. For each qualifying local unit, an “excess residential contribution percentage” shall be computed as the excess residential value determined in paragraph (1) above, divided by the total excess residential value of the qualifying local unit.

14-107 Distribution of Areawide Tax Base

- (1) The state [commissioner of revenue] shall certify to the administering fiscal officer on or about [date] of each year, the population of each qualifying local unit, the average fiscal capacity, and the fiscal capacity of each individual qualifying local unit.
- (2) The administering fiscal officer shall determine for each qualifying local unit the product of: (a) its population, and (b) the proportion that the respective average fiscal capacity bears to the fiscal capacity of that qualifying local unit. The product shall be the areawide tax base distribution index for that qualifying local unit, provided that if a qualifying local unit is located partly within and without the area, its index shall be that which is otherwise determined hereunder, multiplied by the proportion that its population residing within an area bears to its total population as of the preceding year.
- (3) The administering fiscal officer shall determine the proportion that the index of each qualifying unit bears to the sum of the indices of all qualifying local unit(s). In the case of each qualifying local unit, the administering fiscal officer shall then multiply this proportion by the areawide tax base.
- (4) The product of the multiplication prescribed by paragraph (3) above shall be known as the “distribution value for (year) attributable to [name of qualifying local unit].” The administering fiscal officer shall certify such product to the fiscal officer of the county in which the qualifying local unit or units are located on or before [date].

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- (5) The distribution value attributable to each qualifying local unit shall be apportioned among all component local units exercising taxing authority within the qualifying local unit on the basis of the percentage of the qualifying local unit's residential property tax base lying with the component local unit.

14-108 Taxable Value of Component Local Units: Local and Areawide

- (1) Each county fiscal officer shall determine the taxable value of each component local unit within the county in the manner hereby prescribed. The taxable value of a component local unit is its assessed valuation, as determined in accordance with other provisions of law, subject to the following adjustments:
- (a) there shall be subtracted from its assessed valuation, in each qualifying local unit in which the component local unit exercises *ad valorem* taxing jurisdiction, an amount equal to the qualifying local unit's commercial-industrial contribution percentage times the value of commercial-industrial property, and an amount equal to the qualifying local unit's excess residential contribution percentage, times the value of excess residential property; and
 - (b) there shall be added to the assessed valuation of each component local unit the distribution value apportioned to it under paragraph (5) of Section [14-107], from each qualifying local unit in which it exercises taxing authority.
- (2) This net resulting from the subtraction specified in subparagraph (a) and the addition specified in subparagraph (b) of paragraph (1) above represents the final assessment value for determining the tax rate for each component local unit.

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14-109 Levies and Mill Rates: Local and Areawide

- (1) On or before [*month, day, and year*] and each subsequent year, the county fiscal officer shall apportion the levy of each component local unit in his or her county in the manner prescribed as follows:
 - (a) determine the areawide portion of the levy for each component local unit by multiplying the mill rate of the unit, times the distribution value apportioned to it under paragraph (5) of Section [14-107] above; and
 - (b) determine the local portion of the current year's levy by subtracting the areawide portion determined above from the component local unit's current year's levy.
- (2) On or before [*month, day, and initial year*] and each subsequent year, the county fiscal officer shall certify to the administering fiscal officer the areawide portion of the levy of each component local unit determined pursuant to subparagraph (a) of paragraph (1) above. The administering fiscal officer shall then determine the rate of taxation sufficient to yield an amount equal to the sum of such levies from the areawide tax base. On or before [*month and day*] the administering fiscal officer shall certify said areawide tax rate to each of the county [fiscal officers].
- (3) If a component local unit is located in 2 or more counties, the computation and certifications required above shall be made by the county fiscal officer who is responsible under other provisions of law for allocating between and among the affected counties.
- (4) Within each qualifying local unit, the taxation of each parcel of commercial-industrial property, [including property located within a tax increment financing district, as defined in Section [14-302], shall be determined as follows: the areawide tax rate shall be applied to that percentage of the property equal to the commercial-industrial contribution percentage; the tax rate from all jurisdictions exercising taxing authority over the property shall apply to the remainder of the property.
- (5) Within each qualifying local unit, the taxation of each parcel of residential property shall be determined as follows: the value of the property that is not defined as excess residential property is taxed at the rate applicable by all qualifying local units exercising taxing authority over the property; the areawide tax rate shall be applied to that percentage of the excess residential portion of the property equal to the excess residential contribution percentage; the tax rate from all jurisdictions exercising taxing authority over the property shall apply to the remainder of the excess residential portion of the property.
- (6) The administering fiscal officer shall determine for each county the difference between the total levy on distribution value within the county and the total tax on contribution value within the county. On or before [*month, date*] of each year, he or she shall certify the difference so determined to each county fiscal officer. In addition, the administering fiscal officer shall certify to those county [fiscal officers] for whose county the total tax on

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contribution value exceeds the total levy on distribution value the settlement the county is to make to the other counties of the excess of the total tax on contribution value over the total tax levy on distribution value in the county. On or before [month, date] and [month, date] of each year, each county [treasurer] in a county having a total tax on contribution value in excess of the total levy on distribution value shall pay the excess to the other counties in accordance with the certification of the administering fiscal officer.

14-110 Miscellaneous Adjustments to Local and Areawide Rates and Levies

[Insert adjustments required by virtue of other provisions of law, such as: (a) the proration of such debt or expenditure limitations as are related to the value or valuation of taxable real or personal property; (b) adjustments in assessed valuation required by equalization authorities; (c) changes in required certification dates for tax rolls and the setting of tax rates; (d) adjustments necessitated by reassessments or by properties erroneously omitted from tax rolls; and (e) late or incorrect certifications of levies or tax rates.]

14-111 Changes in Status of Qualifying Local Units

- (1) If a qualifying local unit is dissolved, is consolidated with all or part of another local unit, annexes territory, has a portion of its territory detached from it, or is newly incorporated, the [secretary of state] shall immediately certify that fact to the [commissioner of revenue]. The [secretary of state] shall also certify to the [commissioner of revenue] the current population of the new, enlarged, or successor qualifying local unit, if determined by the [state or local boundary adjustment agency] incident to the consolidation, annexation, or incorporation proceedings. The population so certified shall govern for purposes of this Act until the [state or regional planning agency] files its first population estimate as of a later date with the [commissioner of revenue]. If an annexation of unincorporated land occurs, the population of the annexing qualifying local unit as previously determined shall continue to govern for purposes of this Act until the [state or regional agency] files its first population estimate as of a later date with the [commissioner of revenue].
- (2) In determining the own source revenues or equalized assessed value of property attributable to a successor qualifying local unit for a year prior to a change in status, such amount shall be deemed the sum of the amounts of its predecessor units. If any of the predecessors were divided incident to the change, then for the purposes of this Act, its own source revenues shall be apportioned among its successors in proportion to the division of the population between them, and the equalized assessed value of property located therein shall be allocated to the successor in which the property is located.

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14-112 Tax Collection and Disbursements to Qualifying Local Units

- ◆ The provisions dealing with collection and disbursement may be addressed elsewhere in the property tax code. The following language is presented if it is desired to modify those provisions.
 - [(1) Tax bills rendered to owners of commercial-industrial property shall, among other items, include: (a) the total assessed value of the property; (b) the value of the areawide portion, the areawide tax rate, and the amount due on the areawide portion; and (c) the value of the local portion, the local tax rate, and the amount due on the local portion. Remittances shall be made to the county [collector(s) of revenue] of the area county or counties in which the property is located.
 - (2) Tax bills rendered to owners of residential property shall, among other items, include: (a) the total assessed value of the property; (b) the value of the areawide portion, the areawide tax rate, and the amount due on the areawide portion; and (c) the value of the local portion, the local tax rate, and the amount due on the local portion. Remittances shall be made to the county [collector(s) of revenue] of the area's county or counties in which the property is located.
 - (3) The county fiscal officer of each county shall transfer to the component taxing jurisdictions within the county, the amounts attributable to respective local rates and to the qualifying local units their respective distributive shares of the areawide tax, as calculated pursuant to Section [14-107] of this Act.]

14-113 Separability [*Insert separability clause.*]

14-114 Effective Date [*Insert effective date.*]

INTERGOVERNMENTAL AGREEMENTS

Commentary: Intergovernmental Agreement for a Joint Economic Development Zone

The following model provides for a voluntary intergovernmental agreement among two or more units of local government to establish a joint economic development zone. The statute is based on legislation from Michigan, Ohio, and Virginia.³⁶ Under this model, the zone may be located within the boundaries of one or more local government units. The local governments negotiate what public

³⁶Mich. Comp. Laws §124.505 (1991); Ohio Rev. Code §§715.69 to 715.71 (1995) (these sections cover “joint economic development zones” for municipalities and “joint economic development districts” for municipalities and unincorporated townships); and Code of Va., Ch. 26.2:1 (1994).

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services and facilities are to be provided to the area included in the zone, and which tax and other revenues that result from commercial, industrial, and other development will be shared, and in what amounts or proportions. Local governments may also address joint planning and joint administration of development regulations in the agreement. In addition, as a quid pro quo, a municipality may agree not to annex land in an unincorporated area in exchange for sharing of revenue. Or a municipality may annex land from the unincorporated area and share the resulting revenues with the county or township.

The model statute lists the typical taxes – real property, sales, and income – that states generally authorize as potential sources of revenue for voluntary sharing. Some states may also permit local lodging, restaurant, or specialized sales taxes. Because each state has its own suite of taxes and other revenue sources that may be levied by local governments, this model must be adapted to address those sources.

It should be noted, however, that the model statute does not contemplate extraterritorial taxation. For example, if the state permits municipalities to levy local income taxes, and the joint economic development zone is located in an unincorporated area, then the municipality could not impose its local income tax on residents and business in that area. But, if the economic development zone were located in the municipality, then the municipality could collect its income tax and share its benefits with the county, township, or other unincorporated unit under a distribution formula contained in the agreement.

14-201 Joint Economic Development Zone

- (1) Two or more local governments may enter into a contract whereby they agree to share in the costs of improvements and/or services and in the revenues from taxes and other revenue sources for an area located in one or more of the contracting local governments that they designate as a joint economic development zone for the purposes of facilitating new or expanded growth for commercial and/or industrial development in the state, ensuring the equitable sharing of resources and liabilities among the contracting local governments, and providing an alternative to annexation. The zone created shall be located within the territory of one or more of the contracting local governments and shall consist of all or a portion of such territory.
- (2) The contract shall set forth:
 - (a) the names of the contracting local governments;
 - (b) a legal description of the area to be designated as the joint economic development zone, including a map in sufficient detail to denote the specific boundaries of the area or areas;
 - (c) the amount or nature of the contribution of each contracting local government to the development and operation of the zone. The contributions may be in any form to

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- which the contracting governments agree and may include, but shall not be limited to, the provision of services, money, real or personal property, facilities, or equipment. The contract shall provide a schedule for the provision of any new, expanded, or additional services and facilities;
- (d) any other terms and conditions identified pursuant to paragraphs (3) (4), (5), and (9) of this Section; and
 - (e) terms setting forth the duration of the contract.
- (3) The contract shall set forth the formula or formulas for allocating any tax and other revenues to be shared from the joint economic development zone and a schedule and method of distribution of the shared revenues, as may be agreed upon by the contracting local governments. Taxes and other revenues to be shared may include:
- [(a) any [municipal *or* local] income tax revenues derived from the income earned by persons employed by businesses that located within the economic development zone after it is designated as such by the contracting local governments and from the net profits of such businesses;]
 - [(b) any local real property tax revenues derived from commercial and industrial real property located in the economic development zone after it is designated as such by the contracting local governments;]
 - [(c) any local revenues resulting from fees, charges, and fines derived from commercial and industrial real property located in the economic development zone after it is designated as such by the contracting local governments;]
 - [(d) any local sales tax revenues derived from sales from businesses located in the economic development zone after it is designated as such by the contracting local governments] and;
 - [(e) [*add other taxes that could be shared*].]
- (4) The contract may provide for the joint comprehensive planning of the economic development zone and the administration of zoning, subdivision, and other land-use regulations, building codes, inspection of public improvements, and other regulatory and proprietary matters that are determined, pursuant to the contract, to be for a public purpose and to be desirable with respect to the operation of the economic development zone or to facilitate new or expanded economic development, provided that no contract shall exempt the territory within the zone from procedures and processes of land-use regulation applicable pursuant to local regulations or ordinances.

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- (5) The contract may provide for a waiver of annexation rights pursuant to [*the state annexation statute*] and such other provisions as the contracting local governments may deem in their best interests.
- (6) Before the legislative authority of any of the contracting local governments enacts an ordinance approving a contract to designate a joint economic development zone, the legislative authority of each of the contracting local governments shall hold a public hearing concerning the proposed zone and contract. Each such legislative authority shall provide at least [30] days notice of the public hearing in a newspaper of general circulation in the area served by the local governments [and may give notice by publication on a computer-accessible information network or by other appropriate means].
- (7) The public notice advertising the hearing shall:
 - (a) contain a statement of the substance of the hearing and a description, including a map, of the proposed joint economic development zone;
 - (b) specify the officer(s) or employee(s) of the legislative authority from whom additional information may be obtained;
 - (c) contain a statement that a true copy of the contract is available for public inspection in the office of the [clerk of the legislative authority] of each of the contracting local governments; and
 - (d) specify the date, time, place, and method for presentation of statements by interested persons.
- (8) After the public hearings required by this Section have been held, the legislative body of each contracting local government may enact an ordinance approving the contract to designate the joint economic development zone. Prior to the enactment of the ordinance, the legislative bodies of the contracting local governments may modify the contract as a consequence of statements made at the public hearings or for any other reason without holding additional public hearings.
- (9) A contract entered into pursuant to this Section may be amended, and may be renewed, canceled, or terminated as provided in or pursuant to the contract. The contract shall continue in existence throughout its term and shall be binding on the contracting parties and on any entities succeeding to such parties, whether by annexation, merger, or otherwise.
- (10) Upon the enactment of an ordinance approving a contract to designate a joint economic development zone or any amendments to the contract, the contracting party shall certify a copy of the ordinance and the contract to the director of the [state department of development *or* state planning agency], who shall maintain a list of local governments in the state that have established joint economic development zones.

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REDEVELOPMENT AND TAX RELIEF

*Commentary: Redevelopment Areas*³⁷

THE BENEFITS AND PROBLEMS OF REDEVELOPMENT

Redevelopment, as the name implies, involves the development or improvement of an area that has at some time (recent or distant) undergone development but has since deteriorated socially or physically, suffered some calamity, or that development has become obsolete. As this Section uses the term, redevelopment applies to areas where market forces are not providing sufficient capital and economic activity for a recovery; where public investment, capital improvements, or promotion and technical assistance are required to “prime the pump.”

The methods for achieving redevelopment are many. The local government may improve the business climate or livability of the area, and demonstrate confidence in its recovery, by making capital improvements and improving public services – fixing and upgrading streets and sidewalks, providing better parks and playgrounds, repairing and expanding schools and libraries, hiring street cleaners. It may improve the image of the area among potential investors, merchants, and residents with advertising and marketing. Assistance in the form of advice and information may be provided to new and existing businesses in the area. Loans may be made to persons renovating their residence or business, or the local government may secure such loans made by private lenders. Grants and tax breaks may be provided for residential or business improvements. Larger businesses may be encouraged with financial and other incentives to locate facilities in the area.

Every state has at least one statutory system for creating, financing, and operating redevelopment areas. The problem is that most states have several such systems, each with different purposes, adoption procedures, financing, and methods of redevelopment. Many of these separate laws overlap; several different statutory schemes potentially apply to the same area in need of redevelopment. These separate statutes were often created to receive or transmit funding or other assistance from particular Federal or state programs.

Since one of the functions of redevelopment is to make investment in the redevelopment area more straightforward and certain, there is a need to replace this confusing multiplicity of enabling legislation with a single, flexible redevelopment statute. While there are as many different redevelopment programs as there are reasons or causes for redevelopment, there are many common elements in redevelopment that can be addressed by a statute that is sufficiently specific to provide guidance to local governments while being general enough that redevelopment programs are tailored to the particular redevelopment area.

³⁷See generally Donald G. Haman and Julian C. Juergensmeyer, “Urban Renewal and Downtown Revitalization,” in *Urban Planning and Land Development Control Law*, (2nd Ed.) (St. Paul, Minn.: West, 1986), 526-553; Daniel R. Mandelker, Gary Feder, and Margaret Collins, *Reviving Cities with Tax Abatement* (New Brunswick, N.J.: Center for Urban Policy Research, 1980) (analysis of impact of Missouri Urban Redevelopment Corporations Law).

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FEDERAL STATUTES ON REDEVELOPMENT

There have been several Federal programs for providing financial assistance to local redevelopment activities, going back to the Federal Housing Act of 1949,³⁸ if not further to New Deal programs. The earlier programs took the form of “urban renewal” or “slum clearance”: in areas characterized by large numbers of inadequate or dangerous buildings, the local government, with Federal financial assistance, would condemn property containing such buildings, raze the substandard structures, build new buildings, and sell or lease the new property to private owners. These projects were often large, involving the consolidation of dozens of separate lots or parcels under local government ownership and their subsequent redivision after the new buildings and structures were completed.

However, in some instances, entire blocks or neighborhoods of viable buildings were razed due to age and perceived obsolescence, residents and businesses were displaced for months of reconstruction, and the replacement buildings were sometimes priced beyond the means of the previous residential and commercial tenants. In response to some of these excesses, Congress replaced the earlier statutes that authorized major, sweeping, projects with more modest programs that focus on renovating existing buildings where possible, such as the Community Development Block Grant program.³⁹

Another response to urban renewal “horror stories” was a statute⁴⁰ that sets uniform policies for real property acquisition and relocation assistance on Federal projects and federally funded local projects. Negotiated purchase of property is preferred over the employment of eminent domain, and persons and businesses displaced by the renovation or demolition of buildings are to receive compensation for certain expenses incurred as a result of the displacement.

EXISTING STATE REDEVELOPMENT STATUTES

California has a comprehensive Community Redevelopment Law.⁴¹ Before any local government may engage in redevelopment, it must have a planning agency and have adopted a comprehensive plan.⁴² The local government must adopt a redevelopment area plan after due notice and a public hearing, and similar public participation is required for the amendment of a redevelopment area plan.⁴³ The required and authorized content of redevelopment area plans is spelled out in detail, as is an express requirement that the redevelopment area plan be consistent with

³⁸42 U.S.C. §§1441 *et seq.* (1999).

³⁹Federal Housing and Community Development Act, 42 U.S.C. §§5301 *et seq.*.

⁴⁰42 U.S.C. §§4601 *et seq.*.

⁴¹Cal. Health & Safety Code §§33000 *et seq.*.

⁴²Cal. Health & Safety Code §§33301, 33302.

⁴³Cal. Health & Safety Code §§33450 *et seq.*.

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the comprehensive plan.⁴⁴ Redevelopment areas must be found to be predominantly blighted.⁴⁵ In order to avoid some of the excesses of urban renewal in the past, and to avoid appearances of corruption and favoritism, there are detailed provisions governing the purchase and condemnation of real property,⁴⁶ the management of property owned for redevelopment,⁴⁷ and requirements regarding relocation assistance to residents displaced by redevelopment activities.⁴⁸ Also, where a redevelopment area receives tax increment financing, 25 percent of that revenue must be set aside for low and moderate income housing, though not necessarily located within the redevelopment area.⁴⁹ Redevelopment may be financed by tax increment financing, by the issuance of bonds or notes, or by appropriations by the local government from any tax it is authorized to impose.⁵⁰ Within redevelopment areas, the power to approve development may be designated by the plan to the redevelopment agency or the local planning agency.⁵¹

Industrial development in economically depressed areas is encouraged by authorizing local governments to create industrial development authorities, financed by the issuance of industrial revenue bonds. Community facilities districts⁵² and community rehabilitation districts⁵³ may be created by local governments to construct or rehabilitate, respectively, public capital improvements in underdeveloped areas, financed by the issuance of bonds and/or the imposition of special tax levies. Infrastructure finance districts,⁵⁴ governed by an infrastructure financing plan and funded through tax increment financing, are also authorized.

Florida's Community Redevelopment Act⁵⁵ authorizes counties and municipalities to adopt community redevelopment plans for areas where the legislative body has “determined such area to

⁴⁴Cal. Health & Safety Code §§33330 *et seq.*.

⁴⁵Cal. Health & Safety Code §§33030 *et seq.*.

⁴⁶Cal. Health & Safety Code §§33390 *et seq.*.

⁴⁷Cal. Health & Safety Code §§33400 *et seq.*.

⁴⁸Cal. Health & Safety Code §§33410 *et seq.*.

⁴⁹Cal. Health & Safety Code §33607.5.

⁵⁰Cal. Health & Safety Code §§33330 *et seq.*.

⁵¹Cal. Health & Safety Code §§33210 *et seq.*.

⁵²Cal. Gov't Code §§53311 *et seq.*.

⁵³Cal. Gov't Code §§53370 *et seq.*.

⁵⁴Cal. Gov't Code §§53395 *et seq.*.

⁵⁵Fla. Stat. §§163.330 *et seq.*.

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be a slum area, a blighted area, or an area in which there is a shortage of housing affordable to residents of low or moderate income, including the elderly, or a combination thereof, and designated such area as appropriate for community redevelopment.”⁵⁶ The community redevelopment plan must be preceded by a notice and public hearing, and is required to be consistent with the county or municipal comprehensive plan.⁵⁷ Before a community redevelopment plan or redevelopment ordinances may be adopted, written notice must be given to all taxing bodies in the redevelopment area.⁵⁸ Open land may not be acquired by the county or municipality for redevelopment unless the plan includes a series of specific findings provided in the Act.⁵⁹ Counties and municipalities engaging in redevelopment are required to “afford maximum opportunity, consistent with the sound needs of the county or municipality as a whole, to the rehabilitation or redevelopment of the community redevelopment area by private enterprise.”⁶⁰

In order to implement the community redevelopment plan, counties and municipalities are authorized to enter into contracts, acquire and sell land and structures, demolish, renovate, and construct buildings, mortgage real property, acquire and develop air rights over highways and railways, borrow money and receive loans and grants, engage in community policing, and employ several other enumerated powers.⁶¹ They may utilize eminent domain,⁶² issue bonds secured by redevelopment revenue,⁶³ and employ tax increment financing.⁶⁴ Technical assistance⁶⁵ and state grants⁶⁶ are available for community redevelopment. For the state grant program, there are detailed reporting and evaluation requirements that measure redevelopment progress – and how efficiently state funds are being used – with several concrete numerical measures.⁶⁷

⁵⁶Fla. Stat. §163.360.

⁵⁷Fla. Stat. §163.360.

⁵⁸Fla. Stat. §163.346.

⁵⁹Fla. Stat. §163.360.

⁶⁰Fla. Stat. §163.345.

⁶¹Fla. Stat. §163.370.

⁶²Fla. Stat. §163.375.

⁶³Fla. Stat. §163.385.

⁶⁴Fla. Stat. §163.387.

⁶⁵Fla. Stat. §163.445.

⁶⁶Fla. Stat. §163.458.

⁶⁷Fla. Stat. §163.461.

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Florida also has a Uniform Community Development District Act, adopted in 1990.⁶⁸ It replaces former laws on community development districts, although pre-existing community development districts were allowed to continue under their old enabling act.⁶⁹ Districts are granted the usual powers of a body politic and corporate (buy, own, and sell land, form contracts, borrow money, sue and be sued, employ workers as state employees, enact rules, etc.) and are granted the authority to levy fees and taxes as well.⁷⁰ They are governed by a board of supervisors, elected for four-year terms by the landowners of the district, who are allotted one vote per acre owned.⁷¹ Districts may construct and operate public improvements such as water, sewer, highway, transit, and park systems and conservation works.⁷² Though an annual budget is required,⁷³ as is a water management plan when the district provides water service,⁷⁴ there is no requirement of a plan governing the development of the district.

Illinois is the classic case of a state with a plethora of similar redevelopment statutes for various purposes. The Industrial Project Revenue Bond Act,⁷⁵ commercial renewal and redevelopment areas statute,⁷⁶ business district development and redevelopment statute,⁷⁷ and the Tax Increment Allocation Redevelopment Act⁷⁸ all authorize local governments to address different aspects of redevelopment, as the names imply. To administer redevelopment, land clearance commissions,⁷⁹

⁶⁸Fla. Stat. §§190.001 *et seq.*.

⁶⁹Fla. Stat. §190.004.

⁷⁰Fla. Stat. §§190.011, 190.021.

⁷¹Fla. Stat. §190.006.

⁷²Fla. Stat. §190.012.

⁷³Fla. Stat. §190.008.

⁷⁴Fla. Stat. §190.013.

⁷⁵65 Il. Comp. Stat. §§5/11-74-1 *et seq.*.

⁷⁶65 Il. Comp. Stat. §§5/11-74.2-1 *et seq.*.

⁷⁷65 Il. Comp. Stat. §§5/11-74.3-1 *et seq.*.

⁷⁸65 Il. Comp. Stat. §§5/11-74.4-1 *et seq.*, discussed in more detail in the Commentary to Section 14-302, Tax Increment Financing.

⁷⁹Pursuant to the Blighted Areas Redevelopment Act, 315 Il. Comp. Stat. §§5/1 *et seq.*, Illinois' "traditional" urban renewal statute.

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neighborhood redevelopment corporations,⁸⁰ or community development finance corporations⁸¹ may be created.

Despite their varied titles and purposes, there are some similarities between these statutes. Most establish specific criteria for an area to qualify for assistance and specify a relatively narrow set of purposes and forms of assistance. Most require the adoption of a plan governing the redevelopment of the area. The purchase and improvement of real property is expressly authorized in most of the statutes. And they tend to focus intensively on the details on the issuance, redemption, etc. of bonds and other obligations.

Oregon empowers local governments to create urban renewal agencies for the redevelopment of blighted areas pursuant to an urban renewal area plan.⁸² Tax increment financing to pay off urban renewal bonds and notes is expressly authorized.⁸³ Local governments may offer property tax exemptions (with certain conditions ensuring affordability) for new single-family residential construction in distressed areas, to encourage the revitalization of the area and the provision of affordable housing.⁸⁴

The unification of economic development activities at the regional level is encouraged.⁸⁵ Contiguous counties may prepare, with notice and a public hearing, a regional investment plan to govern economic development in the region; the statute specifies the contents of such a plan, and the plan takes effect upon adoption by the governor. The counties may then create a board representing the participating counties to implement it.

Oregon authorizes local governments to engage in business development projects.⁸⁶ The project must be both feasible (development will likely occur) and necessary (development would not occur without the project, and there must be private business participation before the state will grant or lend any money for the project).

⁸⁰315 Il. Comp. Stat. §§20/1 *et seq.*.

⁸¹315 Il. Comp. Stat. §§15/1 *et seq.*.

⁸²Or. Rev. Stat. §§457.010 *et seq.*.

⁸³Or. Rev. Stat. §§457.420 *et seq.*.

⁸⁴Or. Rev. Stat. §§458.005 *et seq.*.

⁸⁵Or. Rev. Stat. §§285B.230 *et seq.*.

⁸⁶Or. Rev. Stat. §§285B.050 *et seq.*.

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BROWNFIELDS⁸⁷

A “brownfield” has been defined as “abandoned, idled, or underused industrial and commercial facilities where expansion or redevelopment is complicated by a real or perceived environmental contamination.”⁸⁸ Since one cannot be aware with certainty of all the chemicals and materials ever used on industrial or commercial premises, or of the level of care with which they were stored, used, and disposed of, the class of land with “perceived environmental contamination” can potentially encompass any lot or parcel ever used for industrial purposes and even for certain commercial purposes (auto repair shops, for instance).

The brownfield problem – a reluctance to purchase and develop already-developed sites due to a perception that they may be polluted – exists to the degree that it does because of the nature of liability under Federal and state laws regarding the cleanup of contaminants and the assessment of the costs of that cleanup. The Comprehensive Environmental Response, Compensation, and Liability Act,⁸⁹ commonly called CERCLA, was adopted with the purpose of holding parties responsible for the pollution of land liable for the costs of removing the pollution and restoring the land to its natural state. However, the language of the statute is somewhat broader: the past and current owners and operators of premises where hazardous substances have been released are financially responsible for the cleanup of the contamination.⁹⁰ There is an exception for parties whose ownership interest exists solely to secure a loan or obligation and entails no control of the premises.⁹¹ There is also an “innocent owner” exception, but it applies only to parties who “unknowingly acquired contaminated property ... and who undertook all appropriate inquiry at the time of acquisition.”⁹² Therefore, CERCLA essentially imposes liability for contamination of land upon the past and present owners and users of the land regardless of their lack of culpability in actually polluting it. Several states

⁸⁷An interesting and useful book on brownfields is Todd S. Davis and Kevin D. Margolis, eds., *Brownfields: A Comprehensive Guide to Redeveloping Contaminated Property*, (Chicago: Amer. Bar Ass’n, 1997). See also Michael B. Gerrard, *Brownfields Law and Practice*, 2 vol. (New York: Matthew Bender, 1999); Peter B. Meyer and Thomas S. Lyons, “Lessons from Private Sector Brownfields Redevelopers: Planning Public Support for Urban Regeneration,” *Journal of the American Planning Association*, 66, No. 1 (Winter 2000):46-57.

⁸⁸U.S. Environmental Protection Agency, Region 5 Office of Public Affairs, *Basic Brownfields Fact Sheet*, (Chicago, 1996).

⁸⁹42 U.S.C. §§9601 *et seq.* (1999).

⁹⁰42 U.S.C. § 9607(a)(1).

⁹¹42 U.S.C. §9601(20)(A). Conversely, the courts have found lenders with a role in the management of the premises to be liable for cleanup costs. *U.S. v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990).

⁹²42 U.S.C. §§9601(35)(A), 9607(b)(3).

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have adopted statutes modeled on CERCLA,⁹³ and indeed some states⁹⁴ have imposed legal frameworks stricter than CERCLA.

While CERCLA and its state counterparts were adopted for the useful and indeed necessary purposes of ensuring a cleaner environment and reducing the exposure of the public to toxic chemicals, there is a negative side effect to the strict liability rule. Potential purchasers and developers of parcels that were once used for industrial purposes become wary of buying and developing such a parcel for fear that they will become responsible for the high cost of cleaning up any contamination caused by previous users. As the potential liability for cleanup of badly contaminated land can total in the millions of dollars, some developers will not even consider parcels that were used for potentially contaminating industrial or commercial purposes. Instead, they will construct their developments on previously undeveloped – and therefore presumably pristine – land. Since “brownfields” are usually located in the 19th and early 20th Century industrial districts of cities and their close-in suburbs, while the most certain place to find untouched “greenfields” near urban labor and markets is just beyond the (present) extent of urban development, sprawl is encouraged. Thus the negative effect on the development of old industrial sites links the “brownfields” problem to redevelopment.

Recognizing the “brownfields” problem, many states have adopted amendments to their environmental protection statutes. These new rules often create exceptions to strict liability,⁹⁵ create voluntary cleanup programs that provide protection from suit for owners who remediate the contamination of their property according to a state-approved plan,⁹⁶ authorize remediation measures that are appropriate to the intended use of the property,⁹⁷ or some combination of these. The U.S. Environmental Protection Agency has assisted in this effort by recognizing the intended land use of contaminated premises as a consideration in the degree or level of cleanup,⁹⁸ and by entering into

⁹³Davis, 17.

⁹⁴See, e.g., N.J. Stat. Ann. §58:10-23.11b.

⁹⁵Del. Code Ann. tit. 7, § 9105; 415 Il. Comp. Stat. §5/58.9 (liability for costs for voluntary cleanup assigned on a fault basis, damages proportional to polluter’s portion of fault); Ohio Rev. Code §3746.26(A)(1)(b) (lenders not liable so long as they do not actually manage or operate any hazardous waste activities on the premises, even if they have the power to manage the premises); 35 Pa. Cons. Stat. Ann. §§6027.1 *et seq.* (lenders liable for contamination only if they caused or exacerbated contamination, or compelled their borrower to do so).

⁹⁶This is the most common approach, adopted by at least 25 states. See e.g., Cal. Health & Safety Code §§25300 *et seq.*; Mich. Comp. Laws §§20101 *et seq.*; Me. Rev. Stat. tit. 38, §343-E; Minn. Stat. §115B.175; Neb. Rev. Stat. §§81-15,181 *et seq.*; Ohio Rev. Code §3746.01 *et seq.*; Pa. Stat. tit. 35, §§6026.101 *et seq.*; Wisc. Stat. §§292.11 *et seq.*.

⁹⁷Colo. Rev. Stat. §25-16-305(1); N.J. Stat. Ann. §58:10B-12; Pa. Cons. Stat. Ann. §§6026.301 *et seq.*.

⁹⁸U.S. EPA, “Land Use in the CERCLA Remedy Selection Process,” OSWER Directive No. 9375.6-11 (May 3, 1995).

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agreements not to sue with the buyers of premises that the EPA regulates.⁹⁹ It has also entered into memoranda of understanding with some state environmental protection agencies, agreeing to refrain from enforcement against premises that the state agency is regulating when that agency finds that no further remediation of pollutants is required.¹⁰⁰ Also, the EPA is permitted, indeed required, by CERCLA to reach a settlement with land owners who (basically) did not store, process, or dispose of hazardous materials on the premises and who had no actual or constructive knowledge that the land had been previously used for the storage, processing, or disposal of hazardous substances, when the settlement involves only a minor portion of the cleanup costs.¹⁰¹ However, the condition that settlement concern only a minor portion of the costs means that this provision, by itself, assists the non-polluting owner only when the actual polluting party or parties can be discovered and made to pay under CERCLA.

CONTENTS OF THE MODEL STATUTE

Section 14-301 below provides a uniform but flexible framework for the redevelopment of areas that require development assistance. There are several authorized grounds for the creation of a redevelopment area; the existence of any two is sufficient authorization to engage in redevelopment. Similarly, a broad range of redevelopment tools is authorized; the local government is empowered to select the tool or tools most appropriate to the particular redevelopment area.

The key to the proper selection of redevelopment tools is the redevelopment area plan, adopted pursuant to Section 7-303. It provides the considered guidance that is crucial to the success of redevelopment. Indeed, it is so essential to redevelopment that without it, the local government is not authorized to create a redevelopment area.

In order to provide the necessary money for redevelopment, the Section authorizes the local government to borrow money and issue bonds secured by the redevelopment property and revenue or by the general revenues of the local government. The local government is also directed to seek out assistance under all applicable state and Federal programs. If the local government decides that the nature or scope of the redevelopment requires a separate entity to conduct redevelopment activities, it may create a redevelopment authority with the powers of a non-profit corporation.

The Section also authorizes the creation of business improvement programs. Essentially the equivalent of business improvement districts (BIDs), these are ongoing programs whereby marketing, capital improvements, and increased services in a business district are financed by a special assessment on the businesses and owners of the district or by tax-increment financing. Their ongoing nature is tempered by the fact that they are subject to periodic review.

All new or renovated housing in a redevelopment area must include affordable housing units, at least 15 percent but no more than 50 percent. Not only does this promote affordable housing as a

⁹⁹Davis, 25-26.

¹⁰⁰Davis, 26, 48-49.

¹⁰¹42 U.S.C. §9622(g)(1).

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general policy, it ensures the success of the redevelopment area. It is clearly wrong to concentrate all lower-income residences in a particular area, so that lower-income households are the sole or predominant residents of the area. A neighborhood needs a significant proportion of middle-class residents to be economically viable. However, gentrification – the complete or near-complete replacement of affordable housing with relatively expensive market-rate housing – is also undesirable.¹⁰² A balance of affordable housing and market-rate residential units is therefore one of the goals of this Section.

Two provisions are included to preclude some of the excesses sometimes attributed to urban renewal. Purchase of land is favored over the employment of eminent domain except where an agreed purchase would be unfeasible. And structurally sound buildings must be renovated instead of destroyed unless the redevelopment area plan provides otherwise. Note that these are not outright prohibitions by any stretch: a local government intent on buying up all the land in a redevelopment area at cheap prices, or on removing all existing buildings from a redevelopment area, could do so by drafting the redevelopment area plan accordingly. The purpose of this provision is to compel the local government to make potentially destructive decisions openly and after public consideration and to ensure that such decisions are consistent with the policies of the local comprehensive plan.

14-301 Redevelopment Areas

- (1) A local government may adopt and amend in the manner for land development regulations pursuant to Section [8-103 *or cite to some other provisions, such as a municipal charter or state statute governing the adoption of ordinance*] redevelopment area ordinances pursuant to this Section.
- (2) The purposes of a redevelopment area are to encourage reinvestment in and redevelopment and reuse of areas of the local government that are characterized by two or more of the following conditions or circumstances:
 - (a) loss of retail, office, and/or industrial activity, use, or employment;
 - (b) [40] percent or more of households are low-income households;
 - (c) a predominance of residential or nonresidential structures that are deteriorating or deteriorated;
 - (d) abandonment of residential or nonresidential structures;
 - (e) environmentally contaminated land;

¹⁰²See Diane R. Suchman, “Mixed-Income Housing” in *Developing Infill Housing in Inner-City Neighborhoods* (Washington, D.C.: Urban Land Institute, 1997), 59-81; Jon C. Teaford, *The Rough Road to Renaissance* (Baltimore, Md.: Johns Hopkins University Press, 1990), 249-250, 305.

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- (f) the existence of unsanitary or unsafe conditions that endanger life, health, and property;
 - (g) deterioration in public improvements such as streets, street lighting, curbs, gutters, sidewalks, related pedestrian amenities, and parks and recreational facilities;
 - (h) tax or special assessment delinquency exceeding the fair market value of the land;
 - (i) recent occurrence of a disaster, as declared by the governor or the President of the United States; or
 - (j) any combination of factors that substantially impairs or arrests the sound growth and economic development of the local government, impedes the provision of adequate housing, or adversely affects the public, health, safety, morals, or general welfare due to the redevelopment area's present condition and use.
- (3) As used in this Section, and in any other Section where “redevelopment areas” are referred to:
- (a) **“Affordable Housing”** means housing that has a sales price or rental amount that is within the means of a household that may occupy moderate- or low-income housing. In the case of dwelling units for sale, housing that is affordable means housing in which annual housing costs constitute no more than [28] percent of such gross annual household income for a household of the size which may occupy the unit in question. In the case of dwelling units for rent, housing that is affordable means housing for which the affordable rent is no more than [30] percent of such gross annual household income for a household of the size which may occupy the unit in question.
 - (b) **“Affordable Housing Cost”** means the sum of actual or projected monthly payments for any of the following associated with for-sale affordable housing units: principal and interest on a mortgage loan, including any loan insurance fees; property taxes and assessments; fire and casualty insurance; property maintenance and repairs; homeowner association fees; and a reasonable allowance for utilities.
 - (c) **“Affordable Rent”** means monthly housing expenses, including a reasonable allowance for utilities, for affordable housing units that are for rent to low- or moderate-income households.
 - (d) **“Affordable Sales Price”** means a sales price at which low- or moderate-income households can qualify for the purchase of affordable housing, calculated on the basis of underwriting standards of mortgage financing available for the housing development.

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- (e) **“Area-Based Finance Method”** means one or both of the following, employed within a redevelopment area in order to finance the provision of redevelopment assistance tools within the redevelopment area:
1. tax increment financing pursuant to Section [14-302]; and
 2. special assessments pursuant to [*cite to special assessment statute*].
- (f) **“Business Improvement Program”** means the employment of one or more of the following in a redevelopment area, financed solely by area-based finance methods and/or loans, bonds, and notes secured by the revenue from area-based finance methods and/or the revenue generated by employment of the redevelopment assistance tools:
1. programs to market and promote the redevelopment area and attract new businesses or residents thereto;
 2. local capital improvements within the redevelopment area, including, but not limited to, the installation, construction, or reconstruction of streets, lighting, pedestrian amenities, public utilities, parks, playgrounds, recreational facilities, and public buildings and facilities; and
 3. improved or increased provision of public services within the redevelopment area, including, but not limited to, police or security patrols, garbage collection, and street cleaning.
- (g) **“Direct Development”** means the acquisition and disposition by the local government or the redevelopment authority of real property in a redevelopment area, and may include one or more of the following:
1. assembly and replatting of lots or parcels;
 2. remediation of environmental contamination;
 3. rehabilitation of existing structures and improvements;
 4. demolition of structures and improvements and construction of new structures and improvements;
 5. programs of temporary or permanent relocation assistance for businesses and residents; and
 6. the sale, lease, donation, or other permanent or temporary transfer of real property to public agencies, persons, and entities both for-profit and not-for-profit.

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- (h) **“Greenfields Area”** means a contiguous area that has never been developed or that has been used solely for agricultural or forestry uses;
- (i) **“Low-Income Household”** means a household with a gross household income that does not exceed 50 percent of the median gross household income for households of the same size within the housing region in which the housing is located.
- (j) **“Low-Income Housing”** means housing that is affordable, according to the federal Department of Housing and Urban Development, for either home ownership or rental, and that is occupied, reserved, or marketed for occupancy by households with a gross household income that does not exceed 50 percent of the median gross household income for households of the same size within the housing region in which the housing is located.
- (k) **“Moderate-Income Housing”** means housing that is affordable, according to the federal Department of Housing and Urban Development, for either home ownership or rental, and that is occupied, reserved, or marketed for occupancy by households with a gross household income that is greater than 50 percent but does not exceed 80 percent of the median gross household income for households of the same size within the housing region in which the housing is located.
- (l) **“Redevelopment Area Plan”** means the subplan or subplans of the local comprehensive plan authorized by Section [7-303];
- (m) **“Redevelopment Assistance Tool”** means one or more of the following:
 - 1. technical assistance programs to provide information and guidance to existing, new, and potential businesses and residences in the redevelopment area;
 - 2. programs to market and promote the redevelopment area and attract new businesses and residents thereto;
 - 3. grant and loan programs to encourage the rehabilitation of residential and non-residential buildings, improve the appearance of building facades and signage, and stimulate business start-ups and expansions within the redevelopment area;
 - 4. programs to:
 - a. guarantee or secure; and/or
 - b. obtain a reduced interest rate, down payment, or other improved terms for

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loans made by private, for-profit or not-for-profit, lenders to encourage the rehabilitation of residential and non-residential buildings, improve the appearance of building facades and signage, and stimulate business start-ups and expansions within the redevelopment area;

5. tax abatement pursuant to Section [14-303];
 6. local capital improvements within the redevelopment area, including, but not limited to, the installation, construction, or reconstruction of streets, lighting, pedestrian amenities, public utilities, public transportation facilities, parks, playgrounds, recreational facilities, and public buildings and facilities;
 7. improved or increased provision of public services within the redevelopment area, including, but not limited to, police or security patrols, garbage collection, and street cleaning;
 8. provision of land-use incentives within the redevelopment area, pursuant to Section [9-501];
 9. provision of assistance, technical, financial, or otherwise, with:
 - a. applications to the [state environmental protection agency]; and/or
 - b. site remediation to remove environmental contaminationfor the redevelopment area or lots or parcels within it, pursuant to [*cite brownfields statute and/or regulations*];
 10. direct development; and
 11. implementation agreements entered into pursuant to Section [7-503].
- (n) **“Redevelopment Authority”** means an entity created pursuant to paragraph (6) of this Section for the purpose of implementing a redevelopment area ordinance.
- (o) **“Redevelopment Program”** means a program pursuant to Federal or state statute that provides redevelopment assistance tools or assists local governments in the provision of redevelopment assistance tools.
- (4) A redevelopment area may be established only pursuant to a redevelopment area ordinance adopted pursuant to this Section.

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- (a) A redevelopment area ordinance shall not be adopted unless the local government has first adopted a local comprehensive plan with a redevelopment area plan pursuant to Section [7-303].
 - (b) A redevelopment area shall not consist of, or include, more than [10 or 25] percent greenfields area, except for redevelopment areas adopted pursuant to paragraph (2)(i) above. Redevelopment within greenfields areas pursuant to paragraph (2)(i) shall not result in greater area, or density or intensity, of development than that in place before the occurrence of the disaster.
- ◆ The purpose of this provision is to prevent the use of redevelopment tools for the initial development of undeveloped territory. However, an absolute limitation would preclude the employment of redevelopment tools by a rural local government to recover from a disaster, and therefore an exception for such a circumstance is necessary. This provision is intended to strike a balance, limiting post-disaster redevelopment in greenfields areas to the restoration of the status quo before the disaster.
- (c) The use of redevelopment assistance tools shall not, in any case, result in any net loss of greenfields area, with the exception of *de minimis* losses.
- ◆ An example of a *de minimis* loss of greenfields due to redevelopment activities would be an addition to a visitor center, or the construction of handicapped-accessible walkways, in a park or forest.
- (5) A redevelopment area ordinance pursuant to this Section shall include the following minimum provisions:
 - (a) a citation to enabling authority to adopt and amend the ordinance;
 - (b) a statement of purpose consistent with the purposes of land development regulations pursuant to Section [8-103] and the purposes of this Section;
 - (c) a statement of consistency with the local comprehensive plan, and with the redevelopment area plan in particular, that is based on findings pursuant to Section [8-104];
 - (d) definitions, as appropriate, for words or terms contained in the ordinance. Where this Act defines words or terms, the ordinance shall incorporate those definitions, either directly or by reference;
 - (e) specific findings, pursuant to the redevelopment area plan and consistent with the purposes of this Section pursuant to paragraph (2) above, supporting the need to employ redevelopment assistance tools in the redevelopment area;

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- (f) a description, both in words and with maps, of the limits or boundaries of the redevelopment area pursuant to the redevelopment area plan;
- (g) a detailed description of the redevelopment assistance tools that will be employed in the redevelopment area and the manner and locations in which they will be employed. Where direct development is to be employed and 42 U.S.C. §§4601 *et seq.*, as amended, is applicable, the local government shall adhere to the uniform relocation assistance and real property acquisition policies pursuant to that statute;
- (h) for any redevelopment area plan that includes or encompasses residential uses, a requirement that any new or renovated housing development that shall receive assistance through any redevelopment assistance tools shall include affordable housing units in a proportion determined by the redevelopment area ordinance but in any case not less than [15] percent nor more than [50] percent. The redevelopment area ordinance shall also include provisions, pursuant to paragraph (9) below, to ensure that affordable housing remains affordable.
- (i) an enumeration of all redevelopment programs for which the redevelopment area may be eligible, and an instruction to the agency or entity designated to oversee and administer implementation of the ordinance pursuant to subparagraph (k) below to apply for and seek inclusion in such redevelopment programs;
- (j) a detailed financial plan, consistent with the local government's budget and its capital improvement program pursuant to Section [7-502], containing reasonable projections of the:
 - 1. cost of the redevelopment assistance tools to be employed; and
 - 2. sources of funding for such costs, including, but not limited to, redevelopment programs and/or area-based finance methods where applicable;
- (k) the designation of one or more public agencies or not-for-profit entities to oversee and administer the implementation of the ordinance. If more than one agency or entity is designated, the ordinance shall specify the jurisdiction or responsibility of each agency or entity in a manner that the relative powers and duties of each are reasonably clear;
- (l) a requirement that any non-governmental entity that receives financial assistance, whether a grant, loan, or loan guarantee, under the redevelopment area ordinance shall make reasonable periodic accountings to the designated agency or entity; and
- (m) either one of the following:

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1. a statement of a specific date after which the redevelopment assistance tools will not be employed within the redevelopment area; or
2. provision for periodic analysis and review by the [local planning agency] of the development activity in the redevelopment area, in light of the purposes of this Section pursuant to paragraph (2) above, regarding the need to employ redevelopment assistance tools in the redevelopment area. Such analysis shall be in writing and shall be submitted to the local legislative body.

except that where the redevelopment assistance tools constitute or include a business improvement program, subparagraph (5)(m)1 shall not apply.

- ◆ Business improvement programs are intended to be ongoing, though not automatically permanent, and therefore are exempted from the absolute time limit “sunset” requirement but are still subject to periodic review.

- (n) provision for the complete disposition of assets, collection of obligations, and repayment of debts remaining at the termination of the redevelopment assistance tools pursuant to paragraph (5)(m) above.

- (6) Consistent with the detailed financial plan of the redevelopment area ordinance pursuant to paragraph (5)(j) above, a redevelopment area ordinance pursuant to this Section may authorize and direct the local government to borrow money through loans, bonds, or notes, which may be unsecured or which may be secured by one or more of the following:

- (a) revenues from area-based finance methods and/or revenues generated from employment of the redevelopment assistance tools;
- (b) real property and other assets held pursuant to the redevelopment area ordinance, including the provision of mortgages, liens, or security interests on the same; and
- (c) the general revenues of the local government.

The redevelopment area ordinance may authorize and direct the local government to guarantee and secure loans made by private lenders by the same means.

- (7) A redevelopment area ordinance pursuant to this Section may create a redevelopment authority and designate it to oversee and implement the redevelopment area ordinance or a portion thereof pursuant to subparagraph (5)(k) above.

- (a) The redevelopment authority shall be governed by a board of directors, consisting of an odd number of directors.

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1. The chairperson of the local planning commission, or the director of the local planning agency if there is no local planning commission, shall be a director *ex officio*. The development area ordinance may specify that other directors shall be local government officials sitting *ex officio*, but no more than half of the directors may be directors *ex officio*.
 2. The other directors shall be [bona fide residents of the local government] appointed by the chief executive officer of the local government with the approval of the local legislative body for a term of [2] years or the duration of the development area pursuant to subparagraph (5)(m) above, whichever is shorter. The redevelopment area ordinance may provide for the staggering of terms of these directors, so that, in each year, half of the directorships under this paragraph (7)(a)2 are subject to appointment.
- ◆ The residency requirement is optional because some adopting legislatures may feel strongly that having outside expertise on the board is more important than having an all-resident board.
3. Except as provided in subparagraph 4 below, or when the redevelopment area has no residents and no business enterprises located in it, at least one director, but no more than half of the directors, shall be:
 - a. a resident of the redevelopment area, if the redevelopment area is predominantly residential in use;
 - b. an officer of a business entity operating a business enterprise in the redevelopment area, or an owner of a more than [10] percent in a business entity operating a business enterprise in the redevelopment area, if the redevelopment area is predominantly commercial or industrial in use; or
 - c. one of each of the above two, if the redevelopment area contains areas of both residential and nonresidential uses.
 4. Where the redevelopment authority is to implement a business improvement program, at least a majority of the directors other than the director or directors *ex officio* shall be officers of business entities operating a business enterprise in the redevelopment area, owners of a more than [10] percent in business entities operating business enterprises in the redevelopment area, or residents of the development area. No two or more directors shall be officers of, or owners of a more than [10] percent interest in, the same business entity.
 5. For the purposes of this paragraph (7)(a), “redevelopment area” includes all redevelopment areas operated or implemented by the same redevelopment authority.

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- ◆ Therefore, if a single non-profit organization is selected to operate multiple redevelopment areas in a local government, the residency or business location requirements do not prevent this.

6. Directors shall be reimbursed for any reasonable expenses incurred in the performance of their duties. Directors pursuant to subparagraph (7)(a)3 or 7(a)4 above shall receive reasonable compensation, as determined by the local legislative body.

(b) Upon the filing of a copy of the redevelopment area ordinance with the [Secretary of State *or other corporate registry*], the redevelopment authority shall have the powers and duties of a not-for-profit corporation pursuant to the [*cite not-for-profit corporation statute*], including, but not limited to:

1. purchasing, holding, improving, mortgaging, selling, leasing, and otherwise conveying property and interests in property;
2. forming, performing, and enforcing contracts, including contracts for the employment of staff and other employees;
3. lending and borrowing money, including loans, bonds, and notes secured by the revenues or assets of the redevelopment authority. However, no debt or obligation of the redevelopment authority shall be an obligation of the local government, or secured by revenues from area-based finance methods or by the general revenues of the local government, unless it is first approved by the local legislative body; and
4. suing and being subject to civil suit.

All amendments to the redevelopment area ordinance shall be filed with the [Secretary of State *or other corporate registry*] in the same manner as the original ordinance.

- ◆ The recording of the redevelopment area ordinance, and any amendments thereto, both emphasizes the corporate nature of the redevelopment authority and makes the powers and duties of the authority clearer to the public.

(c) The redevelopment area ordinance may delegate to the redevelopment authority the power to exercise eminent domain pursuant to [*cite eminent domain statute for local governments*].

(d) The redevelopment area ordinance shall describe the amounts, sources, and nature of the capitalization of the redevelopment authority.

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1. It may provide that revenue from area-based finance methods shall be conveyed to the redevelopment authority to finance its implementation of the redevelopment area ordinance.
 2. It shall provide for the complete disposition of any assets, profits, and/or debt of the redevelopment authority remaining at the conclusion of the redevelopment area ordinance pursuant to subparagraph (5)(m) above. Where a redevelopment authority manages or operates more than one redevelopment area, the ordinance may provide for final disposition when all redevelopment areas managed or operated by the redevelopment authority conclude pursuant to subparagraph (5)(m).
- ◆ It is therefore up to the local legislative body whether each redevelopment area operated by a common redevelopment authority is accounted for, and thus liquidated, separately or jointly.
- (e) The redevelopment authority shall make, to the local legislative body:
 1. annual reports and accountings; and
 2. other accountings as required by the local legislative body.
 - (8) No director, official, or employee of any agency or entity designated to oversee and implement the redevelopment area ordinance or a portion thereof pursuant to subparagraph (5)(k) above, shall:
 - (a) have any substantial financial interest in any land or business enterprise located in the redevelopment area, including such an interest held by a relative by blood, adoption, or marriage or by a business entity in which the official or employee has more than a [10] percent interest. The ownership or rental of one's primary residence within the redevelopment area is not by itself a substantial financial interest for the purposes of this paragraph;
 - (b) own or control, directly or indirectly, more than a [10] percent interest in a business entity that has been or will be awarded, or is under consideration for the awarding of, a contract pursuant to the implementation of the redevelopment area ordinance; or
 - (c) accept or receive, directly or indirectly by rebate, gift, or otherwise, money or any other thing of value from an individual or business entity to whom a contract may be awarded pursuant to the implementation of the redevelopment area ordinance.

The provisions of subparagraphs (a) [and (b)] above shall not apply to directors of a redevelopment authority that are appointed pursuant to subparagraphs (7)(a)3 or 7(a)4 above. However, such directors shall recuse themselves from the [consideration and] decision of all matters that directly affect their property or enterprise in the redevelopment area.

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- ◆ Without this last provision, directors appointed to represent the residents or businesses of the redevelopment area would inherently run afoul of these conflict-of-interest provisions.
 - (9) To ensure that residential development subject to a condition pursuant to paragraph (5)(h) above provides affordable housing, a local government shall enter into a development agreement, pursuant to Section [8-701], with the owner of real property subject to such a condition before it employs redevelopment assistance tools in relation to those premises.
 - (a) The development agreement shall provide for a period of availability for affordable housing as follows:
 - 1. Newly constructed low- and moderate-income sales and rental dwelling units shall be subject to affordability controls for a period of not less than [15] years, which period may be renewed pursuant to the development agreement;
 - 2. Rehabilitated owner-occupied single-family dwelling units that are improved to code standard shall be subject to affordability controls for at least [5] years.
 - 3. Rehabilitated renter-occupied dwelling units that are improved to code standard shall be subject to affordability controls on re-rental for at least [10] years.
 - 4. Any dwelling unit created through the conversion of a nonresidential structure shall be considered a new dwelling unit and shall be subject to affordability controls as delineated in subparagraph (9)(a)1 above.
 - 5. Affordability controls on owner- or renter-occupied accessory apartments shall apply for a period of at least [5] years.
 - 6. Alternatives not otherwise described in this subparagraph shall be controlled in a manner deemed suitable to the local government and shall provide assurances that such arrangements will house low- and moderate-income households for at least [10] years.
 - (b) In the case of for-sale housing developments, the development agreement shall include the following affordability controls governing the initial sale and use and any resale:
 - 1. All conveyances of newly constructed affordable housing dwelling units that are for sale shall contain a deed restriction and mortgage lien, which shall be recorded with the county [recorder of deeds *or equivalent official*]. Any restrictions on future resale shall be included in the deed restriction as a condition of approval enforceable through legal and equitable remedies.

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2. Affordable housing units shall, upon initial sale, and resale in the period covered by the development agreement, be sold to eligible low- or moderate-income households at an affordable sales price and affordable housing cost.
 3. Affordable housing units shall be occupied by eligible low- or moderate-income households during the period covered by the development agreement.
- (c) In the case of rental housing developments, the development agreement shall include the following affordability controls governing the use of affordable housing units during the use restriction period:
1. rules and procedures for qualifying tenants, establishing affordable rent, filling vacancies, and maintaining affordable housing rental units for qualified tenants;
 2. requirements that owners verify tenant incomes and maintain books and records to demonstrate compliance with the agreement and with the ordinance; and
 3. requirements that owners submit an annual report to the local government demonstrating compliance with the agreement and with the ordinance.
- (d) The development agreement shall include a schedule that provides for the affordable housing units to be built or rehabilitated concurrently with the units that are not subject to affordability controls.
- (10) The local government [or the redevelopment authority] shall acquire real property in a redevelopment area by eminent domain only where and to the extent that the redevelopment area ordinance, as amended, specifically states, supported by findings therein including substantial and specific financial and appraisal information, that purchase of the real property would be unfeasible. Purchase shall be deemed unfeasible where it would increase the cost of acquisition beyond the funding available or where it would unreasonably delay the implementation of the redevelopment area plan.
- ◆ Therefore, it is not sufficient for the implementing agency or entity to determine that purchase would be unfeasible. The local legislative body must agree, and there must be data to support the findings.
- (11) (a) Wherever it is not inconsistent with the redevelopment area plan, structurally-sound buildings and structures that are designated for redevelopment pursuant to the redevelopment area ordinance shall be renovated and not destroyed.

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- (b) A historic landmark, as defined in Section [9-301], shall not be destroyed or demolished pursuant to the redevelopment area ordinance unless the redevelopment area plan specifically declares, upon reasonable findings, that the landmark building or structure is not structurally sound and cannot be rendered structurally sound and habitable except at a prohibitive cost. Such findings shall specifically include a reasonable estimate of the cost of rendering the building or structure sound and habitable.

Commentary: Tax Increment Financing

BASICS¹⁰³

Tax increment financing, or “TIF,” is a method of financing redevelopment activities that is directly tied to the success of those activities. With some exceptions, an economically depressed area of a local government brings in much less tax revenue than an economically healthy area of equivalent size and population. If such an area can be made attractive to developers, and tax-generating private development occurs where it has not in recent years, then the tax revenue collected from the area should rise. Tax increment financing taps into this increase in tax revenue to finance the improvements and activities that make redevelopment occur.

Essentially, the local government determines the property tax revenue it is collecting in the given area before redevelopment occurs. The local government then borrows money, with loans or by the sale of bonds. The borrowed funds are used in various ways to improve the development prospects of the area: loans to new businesses, capital improvements, new services such as improved street cleaning and security patrols, advertising and marketing. As development occurs in the area, tax revenue increases, and the excess above pre-redevelopment property tax revenue in the area is used to pay off the loans or bonds and to finance further redevelopment activities. That excess is the “tax increment” in tax increment financing.

TIF ISSUES

Tax increment financing sounds very attractive – the local government is (theoretically) not giving up any revenue, as the tax increment would not (again, theoretically) exist were it not for the

¹⁰³A good introduction to tax increment financing is Sam Casella, Tschangho John Kim, Clyde W. Forrest, and Karen A. Przepyszny, *Tax Increment Financing Planning Advisory Service Report No. 389* (Chicago: Amer. Planning Ass’n, 1985). See also Donald G. Haman and Julian C. Juergensmeyer, *Urban Planning and Land Development Control Law, 2nd Ed.* (St. Paul, Minn.: West, 1986), 551-553; Jonathan Davidson, “Tax-Related Development Strategies for Local Government,” in J. Benjamin Gailey, ed., *1985 Zoning and Planning Law Handbook*, (New York: Clark Boardman Co., 1985) 234-241; Christina G. Dudley, “Tax Increment Financing for Redevelopment in Missouri: Beauty and the Beast,” *U. Mo. K.C. L. Rev.* 54. (1985): 77; Jonathan M. Davidson, “Tax Increment Financing as a Tool for Community Development,” *U. Det. J. Urb. L.* 56 (1979): 405.

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redevelopment activities financed by that increment. However, there are potential problems with TIF.

If tax increment financing is imposed where it is not needed to encourage development – where development would have occurred in the absence of TIF – then the tax increment does not represent (or only a portion represents) local government revenues that would not have otherwise been collected. Instead, the tax increment cuts into general revenue that the local government would have otherwise received.

This is especially problematic when the tax increment consists not only of the “additional” property tax revenue otherwise payable to the local government but of a general cap at pre-TIF levels on property valuations or tax assessments. If tax increment financing is structured in this manner, and is imposed when not necessary, the tax increment also deprives other governmental bodies that receive property tax revenue – school districts, other special districts, the county, and so forth – of the increase they would otherwise have received.

LEGAL CHALLENGES TO TIF

Statutes authorizing tax increment finance have been challenged in the courts on a variety of theories. The most broadly-applicable grounds – basic constitutional arguments of due process and equal protection – have also been the least successful. Since the property tax assessed and collected from the landowner remains the same, property in the TIF district is not being classified separately from land outside the district for purposes of equal protection and uniform taxation clauses.¹⁰⁴ Courts have rejected claims by taxpayers outside a TIF district that the shifting of tax revenues under tax increment financing causes them to bear a burden for which they receive no benefit.¹⁰⁵ The allocation of TIF money to private development has been upheld against legal challenge when the private benefits were incidental to the implementation of a redevelopment plan that served a valid public purpose.¹⁰⁶ Allegations that TIF constitutes a taking have also been unsuccessful,¹⁰⁷ as have claims that the allocation of TIF revenue to a religiously-affiliated entity in the redevelopment area constituted a violation of the establishment of religion clause of the First Amendment (and its state-constitution equivalents).¹⁰⁸

¹⁰⁴*State ex rel. Schneider v. City of Topeka*, 605 P.2d 556 (Kan. 1980); *Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979).

¹⁰⁵*South Bend Pub. Trans. Corp. v. City of South Bend*, 428 N.E.2d 217 (Ind. 1981).

¹⁰⁶*Meierhenry v. City of Huron*, 354 N.W.2d 171 (S.D. 1984); *Short v. City of Minneapolis*, 269 N.W.2d 331 (Minn. 1978); *Tribe v. Salt Lake City Corp.*, 540 P.2d 499 (Utah 1975).

¹⁰⁷*Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979); *Richards v. City of Muscatine*, 237 N.W.2d 48 (Iowa 1975).

¹⁰⁸*In re Minneapolis Community Dev. Agency*, 439 N.W.2d 708 (Minn. 1989), cert. den'd 493 U.S. 894 (1989).

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On the other hand, specific provisions in state constitutions have been the basis for successful challenges to TIF statutes and ordinances on some occasions. Several states impose debt limits on local governments, and while some courts have found that bonds financed with tax increments do not apply to the debt limit, on the grounds that the increment would not exist in the absence of TIF,¹⁰⁹ other courts have found that a local government exceeded its limits by issuing TIF-secured bonds.¹¹⁰ Similarly, some courts have struck down TIF ordinances that included a bond issue on the basis that the issuance of any local government bonds secured by *ad valorem* taxes must be approved by referendum.¹¹¹ Other states, where only measures that would increase taxes or the tax obligation require approval by the voters, rejected this argument.¹¹² Another effective basis for legal attacks on TIF has been specific constitutional provisions that school taxes could be spent only for the support of public schools; a tax increment on the portion of property taxes intended to fund public schools was deemed an improper diversion of educational funding to non-educational purposes.¹¹³

STATE TIF STATUTES

Nearly every state has adopted statutes authorizing tax increment financing programs to raise funds for redevelopment.¹¹⁴

California pioneered tax increment financing and is one of the leading users of TIF. Under its statute,¹¹⁵ TIF may be imposed only where it “shall be necessary for effective redevelopment.” TIF-eligible redevelopment areas must be blighted, though it is expressly provided that not all property or buildings in the area need be in a blighted condition so long as “such conditions predominate.” Redevelopment areas need not be contiguous. TIF may be applied specifically to promote affordable

¹⁰⁹*State v. Miami Beach Redev. Agency*, 392 So.2d 875 (Fla. 1980); *Denver Urban Renewal Auth. v. Byrne*, 618 P.2d 1374 (Colo. 1980).

¹¹⁰*Richards v. City of Muscatine*, 237 N.W.2d 48 (Iowa 1975).

¹¹¹*City of Tucson v. Corbin*, 623 P.2d 1239 (Ariz. Ct. App. 1980); *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1 (Ky. 1975). But see *Metropolitan Dev. & Housing Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979).

¹¹²*Tax Increment Fin. Comm’n of Kansas City v. J.E. Dunn Constr. Co.*, 781 S.W.2d 70 (Mo. 1989).

¹¹³*Miller v. Covington Dev. Auth.*, 539 S.W.2d 1 (Ky. 1976).

¹¹⁴Alan C. Weinstein & Maxine Goodman Levin, “Tax Increment Financing,” Chapter 33B in Patrick J. Rohan & Eric D. Kelly, eds., *Zoning and Land Use Control*, Vol. 6 (New York: Matthew Bender & Co. 1998).

¹¹⁵Cal. Health & Safety Code §§33000 *et seq.*

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housing in non-blighted areas by financing a Low- and Moderate-Income Housing Fund. A redevelopment plan for the TIF area must be adopted, and it must contain a time limit, which for the exercise of eminent domain can be no more than 12 years from the plan's adoption.

The local government may issue bonds or obligations secured by revenue from the TIF, from the affected or other redevelopment projects, from general local government taxes, or from state and federal assistance funds. The TIF revenue must be deposited into a separate account for the redevelopment area. At least 20 percent of the increment revenue must be spent on low- and moderate-income housing for displaced residents unless housing needs in the local government are already met.

Illinois' Tax Increment Allocation Redevelopment Act¹¹⁶ was the model for the TIF statutes in **Missouri**¹¹⁷ and **South Carolina**.¹¹⁸ The area must be found to be "blighted" (several factors constituting blight are defined) or to constitute a "conservation area" (areas with at least half the housing over 35 years old that are not blighted but may become blighted due to certain enumerated factors) to qualify for tax increment financing. Redevelopment areas must consist of contiguous properties. A redevelopment plan must be adopted for the area before it is created, and the plan must be consistent with the comprehensive plan and found to be necessary to the development of the area. There must be notice – to the public, property owners and residents of the area, and affected taxing units – and a hearing before the redevelopment area can be declared and tax increment financing imposed. The redevelopment area cannot be in effect more than 23 years, and no bond or obligation to finance redevelopment can last longer than the redevelopment area.

The property tax increment itself is derived as follows: The property tax assessments of all the land in the redevelopment area at the time of the adoption of the TIF ordinance are added together. The property tax rates of the various taxing units are then applied to that figure rather than to the present assessed value of the properties, and the sums derived are paid to the taxing units as in the absence of TIF. What is left over from the application of the tax rates to the present assessed values once that sum is paid goes into a special account to cover redevelopment costs and/or debt service on bonds issued to pay redevelopment costs. Under the Illinois statute, local sales taxes may also be subjects of tax increment financing.

To finance redevelopment, the local government may issue bonds and other obligations, secured not only by TIF revenue, but also by general tax revenue, revenues from redevelopment activities, mortgages on redevelopment property, or even the full faith and credit of the local government.

Minnesota, along with California as mentioned above, is one of the leading states in employing tax increment financing. Its statute¹¹⁹ provides that TIF may be applied in certain "redevelopment

¹¹⁶65 Il. Comp. Stat. §§5/11-74.4-1 *et seq.*.

¹¹⁷Mo. Rev. Stat. §§99-800 *et seq.*.

¹¹⁸S.C. Code §§31-6-10 *et seq.*.

¹¹⁹Minn. Stat. §§469.174 *et seq.*.

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districts” and “housing districts” as defined by certain criteria, and in catch-all, less-stringent “economic development districts.” To exclude farmland and undeveloped land from TIF districts, TIF areas cannot include vacant land unless that land meets very specific and narrow criteria. Redevelopment and housing districts may have a duration of 25 years, while economic development districts can last no more than the shorter of 10 years from the adoption of the tax increment financing plan or 8 years from the receipt of the first tax increment. A tax increment financing plan must be adopted for the TIF district after notice and a hearing, and it must specify the redevelopment tools and activities it will be financing. The entire tax increment may be applied to redevelopment costs and debt service pursuant to the TIF plan.

Ohio’s statute¹²⁰ addresses the issue of property taxes assessed on behalf of other governmental units. School districts that are affected by a TIF district must be notified of its creation. The school board must approve the TIF, or a payment in lieu of taxes must be made to the school district, if it will exist more than ten years or affect more than a certain percentage of the assessed valuation. Agreements exempting a portion of the tax increment (that is, paying part of the tax increase to the school district) may also be entered into by the local government and the school district. [Other states have also addressed this issue. **New York**¹²¹ and **Florida**¹²² exempt school districts from the application of tax increment financing. **Kentucky**¹²³ allows taxing units to exempt themselves – a taxing unit must agree with the local government for its tax revenue to be subject to the tax increment.]

More generally, the Ohio TIF statutes provide that a tax increment financing district must be created by ordinance. The ordinance must include a fixed term for the district, not to exceed thirty years, and must be filed with the state Department of Development. The local government must also file annual status reports with the Department for the duration of the TIF district.

CONTENTS OF THE MODEL STATUTE

One of the central features of Section 14-302 below is that tax increment financing is intrinsically linked to the broader redevelopment program it is intended to finance. A TIF ordinance cannot be adopted unless there is a redevelopment area plan in place and an ordinance to implement that plan has been adopted. As with all other land development regulations, a TIF ordinance must be consistent with the development area plan. In this manner, TIF is coordinated with the broader efforts to redevelop a “depressed” or underdeveloped area. Unlike the TIF statutes of some states, this model does not describe how TIF money is to be spent; this is determined by the redevelopment area plan and the redevelopment area ordinance implementing it.

¹²⁰Ohio Rev. Code §§5709.40 *et seq.* (municipalities), §§5709.73 *et seq.* (townships), and §§5709.77 *et seq.* (counties).

¹²¹N.Y. Gen. Mun. Law §970-n.

¹²²Fla. Stat. §163.340(2).

¹²³Ky. Rev. Stat. §§99.751(8), 99.761.

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Another important element of the Section, derived from several of the existing state statutes, is that tax increment financing must be found to be essential; that is, without TIF, the redevelopment area plan could not be implemented. As discussed above, tax increment financing is a special tool to be used only where necessary. On the other hand, redevelopment activity is generally desirable and encouraged, and the *Guidebook* generally does not apply a necessity test to the adoption of a redevelopment area plan or ordinance. Therefore, the necessity requirement has been placed in brackets so that it is optional: each adopting legislature may include or remove it.

There are several places in the text where “on behalf of the local government” is in brackets. This is alternative language, creating two different approaches to property tax increments. With the bracketed phrase omitted, the tax increment represents all new or additional property tax revenue in the redevelopment area, whether collected on behalf of the local government or some other taxing entity (school districts, for instance). When the bracketed language is included, only the additional property tax revenue collected for the local government is included in the tax increment, eliminating claims that TIF is cutting into the tax revenues of other government bodies.

The Section authorizes local governments, at their option, to impose tax increment financing on local sales taxes. Unlike real property taxes, it is typical for local governments to collect their own sales taxes. Therefore, TIF applies under the Section only to the local government’s own sales taxes; there is no alternative language as with the real property tax increment.

The model statute provides for the deposit of the tax increment revenue in a special account and for the distribution of any funds remaining in that account when redevelopment activities terminate. Since the total tax increment represents revenue that was collected pursuant to the regular real property and/or sales taxes but was set aside for a special purpose – redevelopment – when that special purpose terminates, those funds should go where tax revenue normally goes. If the tax increment applies only to the property and sales tax assessed on behalf of the local government, the leftover money goes into the local government’s general fund. If the tax increment represents the additional property and sales taxes that would have gone to all taxing units, the funds are distributed to the taxing units *pro rata*. Unused sales tax increment go back to the local government, since the increment is upon only the local government’s sales tax.

14-302 Tax Increment Financing

- (1) A local government may adopt and amend in the manner for land development regulations pursuant to Section [8-103 *or cite to some other provisions, such as a municipal charter or state statute governing the adoption of ordinance*] a tax increment finance ordinance pursuant to this Section.
- (2) The purposes of tax increment financing are to:
 - (a) finance the redevelopment of duly-established redevelopment areas;

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- (b) raise funds for such redevelopment without unduly burdening the public at large; and
 - (c) account for the costs and benefits of such funding in a manner transparent to the public.
- (3) As used in this Section, and in any other Section where “tax increment financing” is referred to:
- (a) **“Base Individual Property Tax”** means the real property tax assessed [on behalf of the local government] on an individual lot or parcel in the redevelopment area at the last assessment of real property taxes before the adoption of the tax increment finance ordinance;
 - (b) **“Base Sales Tax”** means the taxes levied by, and collected by or on behalf of, the local government pursuant to [*cite sales tax statutes*] on transactions at places of business located within the redevelopment area for the [6] months preceding the calendar month in which the tax increment finance ordinance becomes effective;
 - (c) **“Individual Property Tax Increment”** means the difference between the base individual property tax and the present individual property tax;
 - (d) **“Present Individual Property Tax”** means the real property tax assessed [on behalf of the local government] on an individual lot or parcel in the redevelopment area at the most recent assessment of real property taxes;
 - (e) **“Present Sales Tax”** means the taxes levied by, and collected by or on behalf of, the local government pursuant to [*cite sales tax statutes*] on transactions at places of business located within the redevelopment area for every [6] month period, commencing with the calendar month directly following the month in which the tax increment finance ordinance becomes effective;
 - (f) **“Sales Tax Increment”** means the difference between the base sales tax and the present sales tax;
 - (g) **“Total Base Property Tax”** means the real property tax assessed [on behalf of the local government] on all lots or parcels in the redevelopment area at the most recent assessment of real property taxes;
 - (h) **“Total Present Property Tax”** means the real property tax assessed [on behalf of the local government] on all lots or parcels in the redevelopment area at the most recent assessment of real property taxes;
 - (i) **“Total Property Tax Increment”** means the difference between the total base property tax and the total present property tax; and

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- (j) **“Total Tax Increment”** means the sum of the total property tax increment and the sales tax increment.
- ◆ The total property tax increment should also constitute the sum of all individual property tax increments in the redevelopment area.
 - (4) Tax increment finance may be established only pursuant to a tax increment finance ordinance adopted pursuant to this Section.
 - (a) A tax increment finance ordinance shall not be adopted unless the local government has adopted:
 - 1. a local comprehensive plan with a redevelopment area plan pursuant to Section [7-303]; and
 - 2. a redevelopment area ordinance pursuant to Section [14-301].
 - [(b) A tax increment finance ordinance shall not be adopted unless:
 - 1. redevelopment would not occur in the redevelopment area without employing redevelopment assistance tools as described in the redevelopment area plan; and
 - 2. the redevelopment area plan could not be implemented without tax increment financing.]
 - (5) A tax increment finance ordinance pursuant to this Section shall include the following minimum provisions:
 - (a) a citation to enabling authority to adopt and amend the ordinance;
 - (b) a statement of purpose consistent with the purposes of land development regulations pursuant to Section [8-103] and the purposes of this Section;
 - (c) a statement of consistency with the local comprehensive plan, and with the redevelopment area plan in particular, that is based on findings pursuant to Section [8-104];
 - (d) definitions, as appropriate, for such words or terms contained in the ordinance. Where this Act defines words or terms, the ordinance shall incorporate those definitions, either directly or by reference;
 - [(e) specific findings, pursuant to the redevelopment area plan, supporting that:

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1. redevelopment would not occur in the redevelopment area without employing redevelopment assistance tools as described in the redevelopment area plan; and
 2. the redevelopment area plan could not be implemented without tax increment financing;]
- (f) a description, both in words and with maps, of the limits or boundaries of the redevelopment area pursuant to the redevelopment area plan;
- (g) the procedure for review of the determination of individual property tax increments or the total property tax increment, pursuant to paragraph (9) below; and
- (h) provision that the tax increment finance ordinance shall not become effective until the redevelopment area ordinance pursuant to Section [14-301] becomes effective.
- (6) A tax increment finance ordinance pursuant to this Section may establish sales tax increment financing.
- (a) Before the end of the calendar month in which the tax increment finance ordinance becomes effective, the local government shall determine the base sales tax.
- (b) Every [6] months, commencing with the calendar month directly following the month in which the tax increment finance ordinance becomes effective, the local government shall:
1. determine the present sales tax;
 2. from that number and the base sales tax, calculate the sales tax increment; and
 3. deposit the sales tax increment in the special or separate account pursuant to paragraph (10) below within [15] days of the calculation.
- (c) If the sales taxes levied by the local government are collected by another governmental unit, that unit shall:
1. at least [15] days before the effective date of the ordinance, be provided by the local government with a description and map of the boundaries of the redevelopment area pursuant to the redevelopment area plan, and with the effective date of the tax increment finance ordinance; and
 2. make the calculations required by this paragraph every (6) months and remit the sales tax increment to the local government within [15] days of the calculation, whereupon the local government shall deposit the increment in

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the special or separate account pursuant to paragraph (10) below within [15] days of receipt.

- (7) Upon the request of a local government that is preparing a tax increment finance ordinance, said request including:
- (a) a description and map of the boundaries of the redevelopment area pursuant to the redevelopment area plan, with the map delineating the boundaries of the district in relation to tax parcel boundaries; and
 - (b) a list of the tax identification numbers for all lots or parcels in the redevelopment area,

the county [assessor *or equivalent official*] shall provide the local government with an enumeration of the total base property tax and all base individual property taxes for the redevelopment area.

- (8) Upon the adoption of a tax increment finance ordinance, the local government shall notify the county [assessor *or equivalent official*] of such adoption, including the boundaries of the redevelopment area. Thereafter, until the termination of the redevelopment area ordinance pursuant to Section [14-301(5)(m)], the county [assessor *or equivalent official*] shall, upon each assessment of property taxes pursuant to [*cite real property tax statute*]:
- (a) determine the present individual property taxes, individual property tax increments, total present property tax, and total property tax increment for the redevelopment area.
 - 1. The present individual property taxes for all lots or parcels in the redevelopment area shall be determined in the same manner as for any lot or parcel pursuant to [*cite real property tax statute*].
 - 2. The county [assessor *or equivalent official*] shall compare the total property tax increment to the sum of the individual property tax increments, and shall confirm that the total property tax increment equals the sum of the individual property tax increments;
 - (b) include the amount of the base individual property tax and individual property tax increment, along with a brief description of tax increment financing and redevelopment, on each real property tax bill for the redevelopment area; and

- ◆ Taxpayers in the redevelopment area are thus informed of the manner in which their property taxes are being spent, and are aware that increases are not going into the general fund but specifically into the redevelopment of their area.

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- (c) remit the total property tax increment to the local government and provide the local government with the data on present individual property taxes, individual property tax increments, total property present tax, and total property tax increment for the redevelopment area.
 - (9) Any governmental unit that receives real property tax revenue and/or sales tax revenue from the redevelopment area may seek a review by the local legislative body of the determination of property tax increments and/or sales tax increments, as applicable. The procedure for such a review shall conform to the provisions of Chapter [10] of this Act for land-use decisions, and there shall be a record hearing on all such reviews.
 - (10) The total tax increment, and all revenue from the sale of bonds or notes secured by total tax increment pursuant to Section [14-301(6)(a)], shall be deposited in a special interest-bearing account of the local government treasury, except as provided below.
 - (a) If the redevelopment area ordinance is to be implemented by a redevelopment authority pursuant to Section [14-301], the total tax increment, and all revenue from the sale of bonds or notes secured by total tax increment, may be deposited in a separate interest-bearing, federally-insured account at a bank.
- ◆ This provision allows the TIF funds to be deposited in a stable, but privately-owned, institution if and where the intent is to create a redevelopment authority that has a degree of independence from political influence.
- (b) Except as provided in paragraph (10)(c) below, the funds deposited into the special or separate account, and the interest earned thereon, shall be expended only pursuant to the development area plan, as implemented by the development area ordinance pursuant to Section [14-301], to:
 - 1. finance the employment of redevelopment assistance tools and the implementation of the development area ordinance; and
 - 2. pay principal and interest on bonds or notes issued pursuant to Section [14-301(6)(a)] and secured by the total tax increment.
 - (c) If a redevelopment area ordinance is terminated pursuant to Section [14-301(5)(m)] and any funds are remaining in the special or separate account at that time, the funds shall be

Alternative 1

remitted to the general fund of the local government treasury.

Alternative 2

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conclusively presumed to constitute property tax increments and sales tax increments in the proportion in which such funds were deposited into the account and:

1. to the extent derived from property tax increments, remitted to the county [assessor *or equivalent official*] and distributed to all governmental units that receive property tax revenue from the redevelopment area in proportion to their real property tax rates; and
 2. to the extent derived from sales tax increments, remitted to the general fund of the local government treasury.
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Commentary: Tax Abatement

BASICS

One of the most powerful positive tools for affecting public behavior that government has is the tax system. Deductions, exemptions, and credits exist under the federal and state income tax systems to encourage or protect particular activities, such as investing, buying a house on mortgage, and donating to charity. This is no less true for the property and sales tax. In a modern world where business competes globally and can locate nearly anywhere, lower taxes in a given area can be a strong incentive to locate one's business or residence there. Therefore, the ability to reduce taxes in a redevelopment area should be considered as a useful method for bringing about the economic resurgence of a depressed area. And tax abatement can be used for other purposes. A tax break for historic properties can offset some or all of the cost to the landowner of maintaining their property in a historically correct state. Or the developers of residential projects can be encouraged to include affordable dwelling units with the prospect of a significant tax break.

Tax abatement can take two basic forms. The simpler method is to apply a lower tax rate. This can apply to property taxes or to sales taxes. The reduction of sales tax rates can be an especially effective tool for the rapid revival of an area's retail trade. While moving one's business or residence is a long-term decision made infrequently, retail purchases are made every day by almost every person, and are much more susceptible to immediate change.

The more complex method of abating taxes is the property tax freeze. The assessed valuation of real property in the redevelopment area is "frozen" as of a specified date, and real property taxes are levied against that property according to the assessed value on the specified date instead of the present value of the property. Therefore, any increases in the value of real property, whether due to capital improvements to the particular property or to the general economic improvement of the neighborhood, will not result in a higher tax bill that could act as a disincentive to further investments or improvement.

In theory, a property tax freeze should not reduce tax revenues, since the increase in property values in a redevelopment area is attributable to the redevelopment program, including the tax abatement, and would not have occurred in its absence. However, as with tax increment financing

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(Section 14-302), there can be a significant difference between theory and reality: if a tax freeze is applied in an area that would develop and grow without it, then the abatement of property taxes involves forgoing an increase in tax revenue that would have occurred anyway. And as with tax increment financing, this may especially incite resistance from other taxing bodies if a tax freeze applies to all property taxes in the redevelopment area and not just that of the local government instituting the freeze. And it is not at all clear whether tax abatement commonly results in a permanent increase in economic activity and jobs – it is certainly not unknown for businesses to locate in an area due to tax incentives but leave when the incentives are no longer available.¹²⁴ These problems are not pointed out to discourage the use of tax abatement in general, or property tax freezes in particular, but to encourage the careful consideration and evaluation of their use.

A tool closely related to tax abatement is the payment in lieu of taxes, or PILOT. The owners of an individual lot or parcel of land agree with the local government that a portion or all of the tax liability for that property will be satisfied by a payment determined by the agreement. The payment may take the form of a fixed amount, or may be a percentage of the revenue or profits generated on the property. The payments are typically less than the property tax they replace, and there is greater certainty for both the local government and the property owner when the amount due is easily determined beforehand.

STATE STATUTES

Connecticut¹²⁵ authorizes municipalities to employ tax abatement for “housing solely for low or moderate-income persons or families.” The abatement is implemented through individual contracts between municipalities and the landowners receiving the tax abatement, under which the landowner must spend an amount equal to the abatement on affordable housing and ceases to receive the abatement when the housing is no longer set aside for low or moderate-income households.

Florida law¹²⁶ provides that local governments may exempt sales within “urban infill and redevelopment areas” from the local-option sales surtax upon the application of qualified businesses.

Illinois¹²⁷ authorizes municipalities to enter into “economic incentive agreements” to share or rebate the retailers’ occupation tax with businesses that are developing vacant or underutilized land

¹²⁴There is considerable literature on the subject of the effectiveness of tax incentives. Some useful examples are Timothy Bartik, *Who Benefits from State and Local Economic Development Policies?* (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1991); Roger Wilson, *State Business Incentives and Economic Growth: Are They Effective? A Review of the Literature* (Lexington, KY: Council of State Governments, 1989); Rachel Weber, “Why Local Economic Development Incentives Don’t Create Jobs: The Role of Corporate Governance,” *Urban Lawyer* 32, no. 1 (winter 2000): 97; Margaret Dewar, “Why State and Local Economic Development Programs Cause So Little Economic Development,” *Econ. Dev. Q.* 12 (1998): 68; and Michael Wolkoff, “Chasing a Dream: The Use of Tax Abatements to Spur Urban Economic Development,” *Urban Studies* 22 (1985):305-315.

¹²⁵Conn. Gen’l Stat. §8-215 (1999).

¹²⁶Fla. Stat. §163.2517 (2000).

¹²⁷65 Ill. Comp. Stat. §5/8-11-20 (1999).

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and creating or retaining jobs, where the tax break is necessary to increase the local tax base and/or improve the commercial sector of the municipal economy.

Maryland requires counties and municipalities to grant a property tax credit to all qualified property within an enterprise zone.¹²⁸ It also authorizes them to provide a tax credit, tied directly to the increase in valuation due to redevelopment (and therefore similar to a “freeze”), to qualified brownfields property.¹²⁹ Maryland has also authorized the use of payments in lieu of taxes, or PILOT, agreements for leaseholds on government-owned land,¹³⁰ low-income multifamily rental housing in various forms,¹³¹ rental housing which becomes tenant-owned or cooperative and preserves at least 10 percent of the units for low and moderate income tenants,¹³² land in Baltimore City subject to an urban renewal land disposition agreement,¹³³ certain land in Baltimore City’s “Downtown Management District,”¹³⁴ and certain “economic development projects” in urban renewal areas of Baltimore City.¹³⁵

Ohio¹³⁶ authorizes the exemption of improvements to property in a locally declared blighted area, up to the full value of the improvements if the affected school districts agree to participate and 75 percent of the value if they do not. School districts are expressly authorized to condition their approval on entering into a mutually acceptable compensation agreement with the local government. The exemption can last for up to 30 years for residential properties of three units or smaller and 20 years for all other property.

Oregon¹³⁷ authorizes cities to designate, by ordinance, distressed areas, not to exceed 20 percent of the city’s total area, in which qualified single-family dwellings may be extended a real property tax exemption for up to 10 years. Generally, the tax exemption applies only to the city’s taxes and the taxes of any governmental body that agrees to the exemption, but the exemption applies to all

¹²⁸Md. Code §9-103 (1999).

¹²⁹Md. Code §9-229.

¹³⁰Md. Code §7-501 (2000).

¹³¹Md. Code §§7-502, -503, -505, -506, and -506.1.

¹³²Md. Code §7-506.2

¹³³Md. Code §7-504.

¹³⁴Md. Code §7-504.2.

¹³⁵Md. Code §7-504.3.

¹³⁶Ohio Rev. Code §1728.10 (2000).

¹³⁷Or. Rev. Stat. §§458.005 - 458.065 (1999).

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taxes on the exempt property when the taxes of the city and all agreeing governmental units are 51 percent or more of the property taxes levied on the property in question.

Texas¹³⁸ authorizes tax abatement in designated “reinvestment zones.” A reinvestment zone must be eligible for federal assistance, and the municipality must find that the area arrests or impairs the sound growth of the municipality, retards the provision of affordable housing, or constitutes an economic or social liability. Abatement is extended by taxing bodies to particular property within a reinvestment zone through an abatement agreement, whereby the owner agrees to spend the abated taxes on improvements specified in the agreement and to allow the local government to inspect the premises to ensure the improvements are made. The agreement must also provide for the recapture of abated taxes if the improvements specified are not made. Abatement agreements cannot extend beyond ten years, and their adoption or amendment must be approved by a majority of the taxing body’s governing body. Before a taxing body may enter into abatement agreements, it must adopt guidelines and criteria for such agreements. And before an individual abatement agreement can take effect, the local government must notify all other affected taxing bodies of the proposed agreement and hold a hearing to determine whether “the improvements sought are feasible and practical and would be a benefit to the land to be included in the zone and to the municipality after the expiration of an agreement entered into.”

Vermont¹³⁹ enables local governments to enter into tax stabilization agreements with the owners of “agricultural, forest land, open space land, industrial or commercial real and personal property and alternate-energy generating plants,” under which assessed values, tax rates, or the total tax payment can be frozen. The agreements generally cannot last more than 10 years and must be approved at a town meeting by two-thirds of those present for commercial or industrial property or a majority for other authorized property.

STATE CASE LAW

Many if not most state constitutions include a provision mandating uniformity of taxation. The requirement of uniformity is not absolute, however, and reasonable distinctions and classifications have generally been upheld against challenges based on uniformity provisions.¹⁴⁰ Specifically, state courts tend to uphold tax exemptions granted against local taxes pursuant to officially approved redevelopment plans.¹⁴¹

¹³⁸Texas Tax Code §§312.001 *et seq.*

¹³⁹Vt. Stat., tit. 24 §2741 (2000).

¹⁴⁰*Deluxe Theatres, Inc. v. City of Englewood*, 198 Colo. 85, 596 P.2d 771 (1979); *508 Chestnut Inc. v. St. Louis*, 389 S.W.2d 823 (Mo. 1965); *Visina v. Freeman*, 252 Minn. 177, 89 N.W.2d 635 (1958); *Dole v. Philadelphia*, 337 Pa. 375, 11 A.2d 163 (1940).

¹⁴¹*Denver Urban Renewal Authority v. Byrne*, 618 P.2d 1274 (Colo. 1980); *American Linen Supply Co. v. Dep’t of Revenue*, 617 P.2d 131 (Mont. 1980); *State ex rel. Atkinson v. Planned Industrial Expansion of St. Louis*, 517 S.W.2d 36 (Mo. 1975); *Dayton v. Cloud*, 30 Ohio St.2d 295, 285 N.E.2d 42 (1972).

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CONTENTS OF THE MODEL STATUTE

The Section below, 14-303, is intended to operate integrally with the relevant elements of the local comprehensive plan. For redevelopment, this is the redevelopment area plan pursuant to Section 7-303 and the redevelopment area ordinance under Section 14-301. It is in the plan that the local government makes the finding that an area of the local government is underdeveloped or has deteriorated, sets the boundaries of the redevelopment area, and makes the general decisions on the appropriate tools for redevelopment in that area. The redevelopment area ordinance – and this Section – flesh out and implement the policy decisions of the plan. Tax abatement cannot commence before the redevelopment area ordinance takes effect, and tax abatement must terminate when the local government makes the decision (under Section 14-301) that redevelopment tools are no longer needed in the area. Similar provisions tie tax abatement for affordable housing to the housing element of the local comprehensive plan (Section 7-207), and abatement to support historic preservation is linked to the historic preservation element (Section 7-215).

The Section authorizes the “freezing” of property tax assessed values, the reduction of property tax rates, and/or the reduction of sales tax rates. As was stated earlier, the freezing of all property taxes in a given area or for a particular property may be controversial and objectionable to the other taxing bodies levying property tax in the freeze area. Therefore, in adopting the Section, a state legislature must decide whether valuation freezes apply only to the local government’s own property tax or to all property taxes levied in the freeze area by any taxing body. A related optional provision for redevelopment-focused abatement requires, as a prerequisite to a property tax freeze, that the local government make specific findings, supported by evidence, that a tax freeze is necessary for the development of the redevelopment area.

The impact of removing a freeze and suddenly reapplying present valuation could be a sudden “shock” to the economy of the freeze area and a potential setback to the development already achieved. Therefore, the Section authorizes local governments to phase in present assessed valuation at the end of a property tax freeze.

The Section also authorizes the use of payments in lieu of taxes, or PILOTs. As provided below, the local government and a landowner may enter into a development agreement pursuant to Section 8-701 whereby the landowner makes payments in lieu of a portion or all of the applicable property. The payment may be a fixed sum, a percentage of the gross profits generated on the premises, some combination of the two, or any other method chosen by the parties. Since the revenue is a substitute for general property taxes, the payments in lieu may be applied in whole or in part to the general fund of the local treasury. This distinguishes PILOTs from tax increment financing pursuant to Section 14-302. The creation of PILOT agreements with multiple taxing bodies as parties is expressly authorized, so that PILOT arrangements may be applied to property taxes beyond those imposed by the local government.

14-303 Tax Abatement

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- (1) A local government may adopt and amend in the manner for land development regulations pursuant to Section [8-103 *or cite to some other provisions, such as a municipal charter or state statute governing the adoption of ordinance*] a tax abatement ordinance pursuant to this Section.
- (2) The purposes of tax abatement are to:
 - (a) encourage and foster the redevelopment of economically depressed areas;
 - (b) reduce the burden of maintaining historically or culturally significant property in proper condition; or
 - (c) encourage the inclusion of affordable housing units in new and renovated development; and
 - (d) provide a practical framework through which the impact of property and/or sales taxes may be reduced in order to achieve the aforementioned purpose.
- (3) As used in this Section, and in any other Section where “tax abatement” is referred to:
 - [(a) **“Affected Governmental Unit”** mean any governmental unit that levies real property tax upon property included in a real property tax freeze pursuant to a tax abatement ordinance.]
 - (b) **“Affordable Housing”** means housing that has a sales price or rental amount that is within the means of a household that may occupy moderate- or low-income housing. In the case of dwelling units for sale, housing that is affordable means housing in which annual housing costs constitute no more than [28] percent of such gross annual household income for a household of the size which may occupy the unit in question. In the case of dwelling units for rent, housing that is affordable means housing for which the affordable rent is no more than [30] percent of such gross annual household income for a household of the size which may occupy the unit in question.
 - (c) **“Affordable Housing Cost”** means the sum of actual or projected monthly payments for any of the following associated with for-sale affordable housing units: principal and interest on a mortgage loan, including any loan insurance fees; property taxes and assessments; fire and casualty insurance; property maintenance and repairs; homeowner association fees; and a reasonable allowance for utilities.
 - (d) **“Affordable Rent”** means monthly housing expenses, including a reasonable allowance for utilities, for affordable housing units that are for rent to low- or moderate-income households.

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- (e) **“Affordable Sales Price”** means a sales price at which low- or moderate-income households can qualify for the purchase of affordable housing, calculated on the basis of underwriting standards of mortgage financing available for the housing development.
- (f) **“Freeze Date”** means the date, determined in the tax abatement ordinance, whereupon the assessed value of real property shall be employed as the assessed value for levying the real property tax [on behalf of the local government] so long as the tax abatement ordinance is in effect;
- (g) **“Freeze Value”** means the assessed value of real property as of the freeze date;
- (h) **“Low-Income Housing”** means housing that is affordable, according to the federal Department of Housing and Urban Development, for either home ownership or rental, and that is occupied, reserved, or marketed for occupancy by households with a gross household income that does not exceed 50 percent of the median gross household income for households of the same size within the housing region in which the housing is located.
- (i) **“Moderate-Income Housing”** means housing that is affordable, according to the federal Department of Housing and Urban Development, for either home ownership or rental, and that is occupied, reserved, or marketed for occupancy by households with a gross household income that is greater than 50 percent but does not exceed 80 percent of the median gross household income for households of the same size within the housing region in which the housing is located.
- (j) **“Non-Freeze Value”** means the assessed value that would be employed in the absence of a real property tax freeze.
- (k) **“PILOT Agreement”** means a development agreement, pursuant to Section [8-701], whereby a landowner makes payments in lieu of a portion or all of the real property taxes levied on behalf of the local government;
- (l) **“Real Property Tax”** means the tax created by and levied pursuant to [*cite real property tax statute*];
- (m) **“Real Property Tax Freeze”** means the levying of the real property tax [on behalf of the local government] against the freeze value regardless of subsequent increases in value or improvements to the real property;
- (n) **“Sales Tax”** means the tax created by and levied pursuant to [*cite sales tax statute or statutes*].

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- (4) Tax abatement may be established only pursuant to a tax abatement ordinance adopted pursuant to this Section, and a PILOT agreement may be adopted only pursuant to this Section.
- (a) A tax abatement ordinance or PILOT agreement shall not be adopted unless the local government has adopted a local comprehensive plan with:
1. a redevelopment area plan pursuant to Section [7-303], accompanied by a redevelopment area ordinance pursuant to Section [14-301];
 2. a historic preservation element pursuant to Section [7-215], accompanied by a historic preservation ordinance pursuant to Section [9-301]; and/or
 3. a housing element pursuant to Section [7-207].
- (b) A tax abatement ordinance or PILOT agreement adopted pursuant to:
1. paragraph (2)(a) and (4)(a)1 above shall not employ tax abatement outside a redevelopment area [and shall not employ a real property tax freeze unless development would not occur in the redevelopment area without employing a real property tax freeze as described in the redevelopment area plan];
 2. paragraph (2)(b) and (4)(a)2 above shall employ tax abatement only for property designated as a historic landmark or within a designated historic district pursuant to Section [9-301]; and
 3. paragraph (2)(c) and (4)(a)3 above shall employ tax abatement only for property where affordable housing units shall be created, either by construction, renovation, or the designation of existing housing units as affordable housing units.
- ◆ The optional bracketed provision exists to prevent local governments from abusing its redevelopment powers by freezing real property taxes where development would occur whether taxes were frozen or not. The provision may be especially desirable where the legislature decides to apply property tax freezes to all real property taxes levied in the redevelopment area, by the local government and by other taxing bodies.
- (5) A tax abatement ordinance may provide for one or more of the following:
- (a) a real property tax freeze;
- (b) a reduction in the rate levied by the local government under the real property tax; and/or

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- (c) a reduction in the rate levied by the local government under the sales tax.
- (6) A tax abatement ordinance pursuant to this Section shall include the following minimum provisions:
 - (a) a citation to enabling authority to adopt and amend the ordinance;
 - (b) a statement of purpose consistent with the purposes of land development regulations pursuant to Section [8-103] and the purposes of this Section;
 - (c) a statement of consistency with the local comprehensive plan, and with the:
 - 1. redevelopment area plan and ordinance;
 - 2. historic preservation element and ordinance; or
 - 3. housing element;in particular, that is based on findings pursuant to Section [8-104];
 - (d) definitions, as appropriate, for such words or terms contained in the ordinance. Where this Act defines words or terms, the ordinance shall incorporate those definitions, either directly or by reference;
 - [(e) where the ordinance is adopted pursuant to paragraph (2)(a) and (4)(a)1 and authorizes a real property tax freeze, specific findings, pursuant to the redevelopment area plan, supporting that development would not occur in the redevelopment area without employing a real property tax freeze;]
- ◆ This paragraph is included or deleted in conjunction with the optional language of paragraph (4)(b)1 above.
 - (f) for tax abatement pursuant to paragraphs (2)(a) and (b) and (4)(a)1 and 2, a description, both in words and with maps, of the limits or boundaries of the property eligible for tax abatement. For redevelopment areas, this shall be the boundaries of the area pursuant to the redevelopment area plan, and for historic districts or landmarks it shall be the boundaries of the historic district or landmark pursuant to the historic preservation element;
 - (g) procedures for the review of applications for tax abatement, including the designation of an officer or body to review and approve applications for tax abatement;
 - (h) a statement of:

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1. the freeze date, which shall be the effective date of the tax abatement ordinance if a separate freeze date is not stated; and/or
 2. the reduced tax rate or rates that will be applied;
- (i) a requirement that tax abatement pursuant to paragraphs (2)(c) and (4)(a)3 shall not apply to particular property unless and until the owners of the property enter into a development agreement with the local government, pursuant to Section [8-701] and paragraph (10) below, to ensure the continuing availability of affordable housing for sale or rent; and
 - (j) a provision that a tax abatement ordinance for redevelopment shall not become effective until the applicable redevelopment area ordinance pursuant to Section [14-301] becomes effective and shall terminate upon the termination of the applicable redevelopment area ordinance as provided in Section [14-301(5)(m)]. Notice of said termination shall be transmitted in writing, at least [15] days before the effective date of the termination, to the county [assessor *or equivalent official*][and all affected governmental units].
- (7) A tax abatement ordinance:
- (a) may provide that tax abatement shall not apply to particular property unless and until the owners of the property enter into a development agreement with the local government, pursuant to Section [8-701], containing reasonable conditions to ensure that the purposes of this Section and the public policies of the local government are implemented.
 - (b) that authorizes a real property tax freeze may include a provision for, upon the termination of tax abatement, a gradual transition from applying the freeze value to applying the non-freeze value.
 1. The tax abatement ordinance shall specify in detail the nature and method of the gradual transition.
 2. The local government shall notify the county [assessor *or equivalent official*] [and all affected governmental units], in writing and at least [15] days before their effective date, of the provisions of the tax abatement ordinance regarding gradual transition, and the county [assessor *or equivalent official*] shall implement the gradual transition provisions as notified.
- (8) Upon the adoption of a tax abatement ordinance that authorizes a real property tax freeze and its application to particular property pursuant to the ordinance, the local government shall notify the county [assessor *or equivalent official*][and all affected governmental units] of such adoption and application, including the boundaries of the affected area and the freeze

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date. Thereafter, until the termination of tax abatement pursuant to paragraph (6)(i) above, the county [assessor *or equivalent official*] shall:

- (a) determine the freeze values of all taxable real property in the affected area;
 - (b) upon each assessment of property taxes pursuant to [*cite real property tax statute*], assess and collect the real property tax [of the local government] within the affected area by applying the freeze value instead of the non-freeze value;
 - (c) include the freeze value and the non-freeze value, along with a brief description of tax abatement and the purpose for which it was adopted by the local government, on each real property tax bill for real property in the affected area; and
 - (d) report annually in writing to the local government [and all affected governmental units]:
 - 1. the difference between the real property tax that was collected in the last year pursuant to the tax abatement ordinance and the real property tax that would have been collected in the last year in the absence of the tax abatement ordinance; and
 - 2. where the tax abatement ordinance provides for a real property tax freeze, the non-freeze value for the affected area as a whole.
- (9) A local government may enter into a PILOT agreement as provided in this Section and Section [8-701].
- (a) A PILOT agreement may include the abatement of property taxes, and payment in lieu of said taxes, for any governmental unit levying real property tax upon the affected property that enters into the PILOT agreement with the consent of all other parties.
 - (b) A PILOT agreement shall include, in addition to the requirements of Section [8-701], the following minimum provisions:
 - 1. the amount of the real property tax of the local government that is abated by the agreement, expressed as a percentage of the tax due, a tax rate, an assessed valuation, or some other reasonably clear method;
 - 2. the amount of the payments in lieu of the real property tax abated, including the reasonably clear method by which the amount is calculated if it is not a fixed sum;
 - 3. the dates on which the payments are due; and

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4. for a PILOT agreement pursuant to paragraph (2)(c) and (4)(a)3, the provisions required by paragraph (10) below.
 - (c) A PILOT agreement may contain other reasonable terms and conditions to ensure that the purposes of this Section and the public policies of the local government are implemented.
 - (d) A copy of the PILOT agreement shall be provided to the county [assessor *or equivalent official*]. Thereafter, until the termination of the PILOT agreement according to its terms and conditions, the county [assessor *or equivalent official*] shall levy the real property taxes of the local government, and any other governmental unit that is a party to the PILOT agreement, according to the terms and conditions of the PILOT agreement.
- (10) A development or PILOT agreement pursuant to paragraphs (6)(i) or (10)(b)4 shall include provisions to ensure the availability of affordable housing for sale or rent.
 - (a) The development agreement shall provide for a period of availability for affordable housing as follows:
 1. Newly constructed low- and moderate-income sales and rental dwelling units shall be subject to affordability controls for a period of not less than [15] years, which period may be renewed pursuant to the development agreement;
 2. Rehabilitated owner-occupied single-family dwelling units that are improved to code standard shall be subject to affordability controls for at least [5] years.
 3. Rehabilitated renter-occupied dwelling units that are improved to code standard shall be subject to affordability controls on re-rental for at least [10] years.
 4. Any dwelling unit created through the conversion of a nonresidential structure shall be considered a new dwelling unit and shall be subject to affordability controls as delineated in subparagraph (a) 1 above.
 5. Affordability controls on owner- or renter-occupied accessory apartments shall be applicable for a period of at least [5] years.
 6. Alternatives not otherwise described in this subparagraph shall be controlled in a manner deemed suitable to the local government and shall provide assurances that such arrangements will house low- and moderate-income households for at least [10] years.

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- (b) In the case of for-sale housing developments, the development agreement shall include the following affordability controls governing the initial sale and use and any resale:
1. All conveyances of newly constructed affordable housing dwelling units subject to the affordable housing incentives ordinance that are for sale shall contain a deed restriction and mortgage lien, which shall be recorded with the county [recorder of deeds *or equivalent official*]. Any restrictions on future resale shall be included in the deed restriction as a condition of approval enforceable through legal and equitable remedies.
 2. Affordable housing units shall, upon initial sale, and resale in the period covered by the development agreement, be sold to eligible low- or moderate-income households at an affordable sales price and housing cost.
 3. Affordable housing units shall be occupied by eligible low- or moderate-income households during the period covered by the development agreement.
- (c) In the case of rental housing developments, the development agreement shall include the following affordability controls governing the use of affordable housing units during the use restriction period:
1. rules and procedures for qualifying tenants, establishing affordable rent, filling vacancies, and maintaining affordable housing rental units for qualified tenants;
 2. requirements that owners verify tenant incomes and maintain books and records to demonstrate compliance with the agreement and with the ordinance;
 3. requirements that owners submit an annual report to the local government demonstrating compliance with the agreement and with the ordinance.
- (d) Where affordable housing is being created by construction or renovation, the development agreement shall include a schedule that provides for affordable housing units to be created concurrently with the units that are not subject to affordability controls.

AGRICULTURAL DISTRICTS

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*Commentary: Agricultural Districts*¹⁴²

Agricultural district statutes allow the establishment of special areas where commercial agriculture is encouraged and protected. Land within such areas is then assessed at its use value in agriculture rather than its market or speculative value, a concept called “differential assessment.”¹⁴³ The theory is that, if land is taxed in this way, it will remove the financial pressure that comes about from rising land values, particularly on the fringes of metropolitan areas, and from resulting higher property taxes on farmland to convert that land to nonagricultural use. Some statutes require landowners to enter into agreements that specify minimum periods that land must be retained in agriculture; if land is converted to nonagricultural use before the end of that period, there is a penalty. The statutes may, for example, limit the use of eminent domain in the agricultural districts, prohibit, without the permission of the landowner, special assessments, restrict the ability of local governments to regulate agricultural use through zoning or other measures, and provide protection for the agricultural landowner against nuisance suits. In some cases, there is a relationship between the establishment of the agricultural district and local comprehensive plans.

STATE STATUTES

According to the American Farmland Trust, every state provides property relief, in some form or another, to farmland, and 49 states specifically use differential assessment. Sixteen states have enacted agricultural district legislation. Two states, Minnesota and Virginia, have two agricultural district programs each.¹⁴⁴

¹⁴²The American Farmland Trust, at www.farmland.org, is an excellent clearinghouse of resources on agricultural preservation. A good specific document to examine is American Farmland Trust, *Saving American Farmland: What Works* (Washington, D.C.: American Farmland Trust, 1997).

¹⁴³For an early evaluation of differential assessment of farms and open space, see John C. Keene et al., *Untaxing Open Space*, prepared for the U.S. Council on Environmental Quality (Washington, D.C.: U.S. GPO, April 1976).

¹⁴⁴American Farmland Trust, *Saving American Farmland: What Works* (Washington, D.C.: American Farmland Trust, 1997), ch. 7 (Agricultural District Programs), 197. The states include Delaware (Del. Code tit. 3, §§901 to 930), Illinois [35 Ill. Comp. Stat. §§200/10-110 to -147 (differential assessment in agricultural districts), 55 Ill. Comp. Stat. §§5/5 -12001, -12007 to -12019 (restriction on county’s power to regulate agricultural uses), 505 Ill. Comp. Stat. §5/1-20.3 (creation of agricultural districts), 740 Ill. Comp. Stat. §§70/0.01 to 5 (limit on nuisance liability for farming)], Iowa (Iowa Code §§335.27, 352.1 to .13), Kentucky (Ky. Rev. Stat. Ann. §262.850), Maryland (Md. Code Ann., Agric. §§2-501 to -516; Tax & Prop. §§8-209), Massachusetts (Mass. Gen’l Laws ch. 40L, §§1 *et seq.*), Minnesota (Minn. Stat. §§40A.01 *et seq.*, 473H.01 *et seq.*), New Jersey (N.J. Rev. Stat. §§4:1C-1 to -55), New York (N.Y. Agric. & Mkts. Law §§300 to 310), North Carolina (N.C. Gen. Stat. §§106-735 to -744), Ohio (Ohio Rev. Code Ann. §§929.01 to .05), Pennsylvania (3 Pa. Cons. Stat. §§901 to 915), Tennessee (Tenn. Code Ann. §§43-34-101 to -108), Utah (Utah Code Ann. §§17-41-401 to -406), and Virginia (Va. Code Ann. §§15.1-1506 to -1513, 58.1-3229 to -3252). The entire set of statutes may be viewed at: <http://www.farmlandinfo.org/fic/laws/kwagdis.html>

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California's Williamson Land Conservation Act dates from 1965, although it has been amended numerous times. It allows cities and counties to create agricultural preserves; the minimum size requirement for a preserve is 100 acres, but a local government can depart from this minimum if supported by the local general plan (the California term for a comprehensive plan).¹⁴⁵

Any proposal to establish an agricultural preserve must be submitted to the planning department of the county or city having jurisdiction over the land. If the county or city has no planning department, a proposal to establish an agricultural preserve shall be submitted to the planning commission. Within 30 days after receiving such a proposal, the planning department or planning commission must submit a report thereon to the board or council. However, the board or council may extend the time allowed for an additional period not to exceed 30 days. The report must include a statement that the preserve is consistent with the general plan, and the board or council shall make a finding to that effect. Final action upon the establishment of an agricultural preserve may not be taken by the board or council until the report required by this section is received from the planning department or planning commission, or until the required 30 days have elapsed and any extension granted by the board or council has elapsed.¹⁴⁶ Landowners who wish to have their agricultural property valued at its use value enter into a contract with the local government; the contracts are for a minimum of 10 years, although the contracts can be extended on an annual basis.¹⁴⁷ Once the land is subject to contract, it is valued for agricultural purposes under a "capitalization of income" approach under state law.¹⁴⁸ If the contract is cancelled before the end of its expiration date, the owner is obligated to pay the actual deferred taxes as well as a cancellation fee of 12.5 percent of the fair market value of the property.¹⁴⁹ The California law also contains limitations on the ability to subdivide contracted lands.¹⁵⁰

New York's statute allows the creation of an agricultural district.¹⁵¹ Land in the district that is used for agricultural production is eligible for an agricultural assessment. Creation of the district is initiated by property owners, but the county legislative body, after holding a public hearing, and receiving a recommendation from the county planning board and from a specially-created county agricultural and farmland protection board, may establish the district. The proposal to establish the district may recommend an appropriate review period of either eight, twelve, or twenty years. The

¹⁴⁵Cal. Gov't Code §51230 (1999). For an excellent review of this act, see Dale Will, "The Land Conservation Act at the 32 Year Mark: Enforcement, Reform, and Innovation," *San Joaquin Agricultural L. Rev.* 9 (1999): 1

¹⁴⁶Cal. Gov't Code §51234.

¹⁴⁷Cal. Gov't Code §51244.

¹⁴⁸Cal. Rev. & Tax. Code §423 (1999).

¹⁴⁹Cal. Gov't Code §§51283, 51283.1.

¹⁵⁰Cal. Gov't Code §51230.2.

¹⁵¹N.Y. Agric. & Mkts. Law §§301 *et seq.* (McKinney 1999).

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plan as adopted must, to the extent feasible, include adjacent viable farmlands, and exclude, to the extent feasible, nonviable farmland and non-farmland. The statute requires a review of the proposal by the state commissioner of agriculture and markets, who may modify the proposal, although the county legislative body has final authority over the district's establishment.¹⁵² The statute contains detailed provisions for the valuation of land for agricultural use. If land that received an agricultural assessment is converted to agricultural use, the land is subject to payments equaling five times the taxes saved in the last year in which the land benefitted from the agricultural assessment, plus a interest of six percent a year compounded annually for each year in which an agricultural assessment was granted, not exceeding five years.¹⁵³ The state also contains limitations on the exercise of eminent domain and the advance of public funds that would adversely affect agriculture.¹⁵⁴

One of the **Minnesota** statutes, the "Metropolitan Agricultural Preserves Act," applies to the seven-county Twin Cities metropolitan area.¹⁵⁵ Local governments in the region must certify to the metropolitan council (the regional planning body for the area) which agricultural lands are eligible for designation as agricultural preserves.¹⁵⁶ Under the statute, land ceases to be eligible for designation as an agricultural preserve when the comprehensive plan and zoning for the area have been amended so that the land is no longer planned for long-term agricultural use and is no longer zoned for agricultural use, evidenced by a maximum residential density permitting more than one unit per 40 acres.¹⁵⁷ Owners of certified long term agricultural land may apply to the local government for agriculture assessment and, in so doing, must agree to keep the land in agricultural use through a restrictive covenant; the local government forwards the application, once approved, to the county assessor, the county recorder, the metropolitan council, and the county soil and water conservation district.¹⁵⁸ Agriculture preserves continue until either the landowner or the local government initiates expiration. The preserves have a duration of at least eight years.¹⁵⁹ The

¹⁵²Id., §303.

¹⁵³Id., §305.

¹⁵⁴Id., §305.4.

¹⁵⁵Minn. Stat. Ann. §§47H.02 to 47H.18 (1999).

¹⁵⁶Minn. Stat. Ann. §47H.04, subd. 1.

¹⁵⁷Minn. Stat. Ann. §47H.04, subd. 2. Under the statute, "long-term agricultural land" eligible for designation as an agricultural preserve means land in the metropolitan area designated for agricultural use in local or county comprehensive plans and which has been zoned specifically for agricultural use permitting a maximum residential density of not more than one unit per quarter/quarter. Id., §47H.05, sub. 7.

¹⁵⁸Minn. Stat. Ann. §47H.05-.06.

¹⁵⁹Minn. Stat. Ann. §47H.08.

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restrictive covenant terminates on the date of expiration.¹⁶⁰ The statute limits the ability of local governments to regulate agricultural use in the preserves, unless the restriction “bears a direct relationship to an immediate and substantial threat to the public health and safety.”¹⁶¹ The act requires the metropolitan council to maintain agricultural preserve maps that illustrate certified long term agricultural lands and lands actually covenanted as agricultural preserves. The council must make yearly reports on the agricultural preserves to the state department of agriculture.¹⁶²

Ohio allows owners of agricultural land to apply to the county auditor to place the land in agricultural districts for five years. For the previous three years, the land in a proposed district must have been devoted exclusively to agricultural production and devoted to or qualified for payments and other compensation from a federal land retirement or conservation program. The land area must be at least ten acres, or the activities conducted on the land must have produced an average yearly gross income of at least \$2500 during the three-year period, or the owner must have evidence of an anticipated gross income of that amount from those activities. If the owner withdraws the land from the district, then he or she must pay the county auditor a withdrawal penalty. Land in the district cannot be assessed for sewer, water, or electrical service without permission of the owner. The statute provides a defense from civil nuisance actions for certain agricultural activities.¹⁶³

STATE COURT CASES

In Iowa, the Supreme Court was presented with a case¹⁶⁴ in which the owners of agricultural land were challenging the refusal of a county to include their land in an agricultural district. The Iowa statute¹⁶⁵ specifically requires the local government to consider, among other factors, the effect of the agricultural district on private property rights in determining the existence and boundaries of the district. Since the Iowa statute affects the right of a landowner to commence a civil action for nuisance, and since objectors to the county claimed that the animal-confinement operation the landowners operated constituted a nuisance to its neighbors, the court found that it was a legitimate concern of the county legislative body and a legitimate basis for rejecting the plaintiff’s application.

¹⁶⁰Minn. Stat. Ann. §47H.18.

¹⁶¹Minn. Stat. Ann. §47H.18.

¹⁶²Minn. Stat. Ann. §47H.06, subd. 5.

¹⁶³Ohio Rev. Code §§929.02 to 929.05 (1999).

¹⁶⁴*Peterson v. Harrison County*, No. 126 / 96-1755 (Iowa Sup. Ct., 1998).

¹⁶⁵Iowa Code ch. 352 (1999).

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The Wisconsin Supreme Court considered a case¹⁶⁶ in which that state's agricultural districting, specifically the tax provisions,¹⁶⁷ were challenged as a violation of the uniformity clause of the state constitution. The property tax portions of the statute created a system by which a portion of property taxes for qualified agricultural property is based on a "frozen" 1995 valuation and the rest on an agricultural use valuation. As to the uniformity clause, many states have such a constitutional provision, which requires the property tax valuation and assessment procedures be uniform for all property of the same class. The court found that the constitution requires practical uniformity rather than absolute uniformity and that the case was premature. It therefore dismissed the case. The court further stated that "[t]o prove the statute unconstitutional, an owner of agricultural land will have to (1) satisfy the initial burden by proving that his agricultural land is over assessed and that other agricultural land is under assessed as a result of the statute, and (2) demonstrate beyond a reasonable doubt that [the statute] does not create uniform taxation of agricultural land to the extent practicable."

THE MODEL STATUTE

Section 14-401 below is an adaptation of the California, Minnesota New York, and Ohio agricultural district statutes. Under this model, a local government must have first adopted a local comprehensive plan that contains an agricultural and forest preservation element. It may then adopt an ordinance establishing an agricultural district, which will be effective for ten years and may be reenacted at the legislative body's discretion. The ordinance establishing the district must identify, in both mapped and written form, the affected parcels. It must also establish a maximum density of one dwelling unit per 40 acres in order to create a true agricultural area rather than simply another low-density single-family residential environment.¹⁶⁸

Once the agricultural district is established, a landowner whose property is within it may apply to the county assessor for an agricultural assessment, provided the landowner's property meets certain minimum area (at least 40 acres) and agricultural production requirements. As part of the initial application, the owner must record a restrictive covenant that limits the use of the property to agriculture for a period of nine years. If the application is granted, the land is assessed at its agricultural rather than its market value, and may not be subject to special assessments for water, sewer, streetlights, and sidewalks, without the owner's permission.

¹⁶⁶*Norquist v. Zeuske*, No. 96-1812-OA (Wisc. Sup. Ct. 1997).

¹⁶⁷Wis. Stat. §70.32 (1999).

¹⁶⁸It is important to note that the average size of an economically viable farm may differ from state to state and indeed from region to region within a state. It is recommended that the most current U.S. Census of Agriculture be consulted for average farm size when setting the minimum size requirement for parcels or combination of parcels under common ownership to be eligible for an agriculture assessment. For a good discussion of this issue, see Robert E. Coughlin, "Formulating and Evaluating Agricultural Zoning Programs," *Journal of the American Planning Association* 57, No. 2 (Spring 1991): 183-192, esp. 189 (discussion of preferred density at which land use conflicts between agricultural activity and nonfarm residential uses will be acceptably low to farmers).

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Certain procedures must be followed before eminent domain (for acquisition of more than ten acres) can be used or expenditure of public funds, by grant, loan, interest subsidy, or otherwise, for the construction of nonfarm housing, or commercial or industrial facilities to serve nonagricultural uses of land can occur within the district. Local governments are barred from enacting ordinances that unreasonably restrict or regulate normal farm structures or agricultural use or practices, unless the restriction or regulation bears a direct relationship to an immediate and substantial threat to the public health or safety. The model provides a defense from civil nuisance actions for agricultural activities conducted on land within an agricultural district.

If the land that has been granted an agricultural assessment is converted to nonagricultural use before the nine-year period has lapsed (conversion includes subdivision for nonfarm uses), the owner, or his or her successor, is liable for a penalty equal to five times the taxes saved during the past year (the difference between the taxes that would have been collected if the land had been assessed at its market value and its agricultural value), interest for each year the agricultural assessment has been in effect, up to five years, and any uncollected special assessments. If the district is terminated or not reenacted by the local government, if land is removed from the district, such as by amendment, or if land is acquired through eminent domain, there are no required payments and penalties on the part of the landowner. The model statute requires the landowner to notify the county assessor if conversion takes place.

14-401 Agricultural Districts; Use Valuation of Agricultural Land

- (1) The legislative body of a local government may adopt and amend in the manner for land development regulations pursuant to Section [8-103 *or cite to some other provision, such as a municipal charter or state statute governing the adoption of ordinances*] an ordinance establishing an agricultural district.
- (2) The purposes of an agricultural district ordinance are to:
 - (a) implement the agricultural and forest preservation element of the local comprehensive plan;
 - (b) encourage landowners to make a long-term commitment to agriculture by offering them financial incentives and security of land use;
 - (c) protect land within such districts from the imposition of certain special assessments; and
 - (d) protect land within such districts from acquisition through eminent domain.
- (3) As used in this Section:

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- (a) “**Agricultural District**” means a contiguous area of at least [100] acres in size created under this Section within which parcels of land shall be eligible for assessment for agricultural use and other benefits and protections;
 - (b) “**Agricultural Use**” means the employment of land for the primary purpose of obtaining a profit in money by raising, harvesting, and selling crops, or feeding (including grazing), breeding, managing, selling, or producing livestock, poultry, fur-bearing animals, or honeybees, or by dairying and the sale of dairy products, by any other horticultural, floricultural, viticultural use, by animal husbandry, or by any combination thereof. It also includes the current employment of land for the primary purpose of obtaining profit by stabling or training equines including, but not limited to, providing riding lessons, training clinics, and schooling shows. Wetlands, pasture and woodlands accompanying land in agricultural use shall be deemed to be in agricultural use;
 - (c) “**Conversion to Non-Agricultural Use**” means one or more of the following:
 - 1. the explicit removal of land from an agricultural district by petition of the landowner to the local government that established the district;
 - 2. conversion of land in an agricultural district to use for purposes other than agricultural production, including subdivision for nonfarm-related housing, or commercial or industrial land use, but excluding those uses exempted by subparagraph (4)(f)2 below; and
 - 3. withdrawal of land from a land retirement or conservation program for purposes other than agricultural production;
 - (d) “**Covenant**” means a real covenant or conservation easement initiated by the owner and contained in the application provided for in paragraph (7) below, whereby the owner places limitations on specified land and receives protections and benefits as provided in this Section; and
 - (e) “**Family**” means persons related by blood, adoption, or marriage.
- (4) An agricultural district ordinance shall be adopted and amended pursuant to this Section and shall:
- (a) be adopted or amended by the legislative body of a local government only after it has adopted a local comprehensive plan that includes the elements required by Section [7-202(2)] and that also includes an agriculture and forest preservation element as authorized by Section [7-212];
 - (b) contain a description of the district, which shall include tax map identification numbers for all parcels within the district, and a map delineating the exterior

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boundaries of the district in relation to tax parcel boundaries and the tax parcels contained within the district;

- (c) include a statement of consistency with the local comprehensive plan, and with the agricultural and forest preservation element in particular, that is based on findings pursuant to Section [8-104];
 - (d) include definitions, as appropriate, for such words or terms contained in the ordinance. Where this Act defines words or terms, the ordinance shall incorporate those definitions, either directly or by reference;
 - (e) be effective for a period of [10] years from the date of enactment, and may be reenacted for additional periods of [10] years; and
 - (f) include amendments to the zoning ordinance, applicable to all land within the district, that:
 - 1. limit the density to one dwelling unit per [40] acres; and
 - 2. prohibit commercial and industrial land uses, except as follows:
 - a. storage use of farm buildings that does not disrupt the integrity of the agricultural district;
 - b. commercial use of farm buildings for trades not disruptive to the integrity of the agricultural district, such as carpentry shops, small scale mechanic shops, and similar activities that a farm operator might conduct;
 - c. farm markets that sell agricultural products that are produced by the seller on the premises from which they are sold; and
 - d. [other].
- (5) An agricultural district shall:
- (a) not include any land that is contained in an urban growth area; and¹⁶⁹
 - (b) include not less than [80] percent of its area in agricultural use.

¹⁶⁹See Arthur C. Nelson, "Preserving Prime Farmland in the Face of Urbanization," *Journal of the American Planning Association* 58, No. 4 (Autumn 1992): 467-488.

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- (6) Upon adoption of an agricultural district ordinance, the clerk of the local government shall, within [30] days, certify a copy of the ordinance to the county [assessor *or equivalent official*], to the [state planning agency], and to the state department of agriculture.
- (7) (a) Any owner of land used in agricultural production within an agricultural district shall be eligible to apply for an agricultural assessment, effective for [9] years.
1. An agricultural assessment shall be granted only upon an application by the owner of such land on a form prescribed by the state [tax commissioner *or other official*]. The applicant shall furnish to the county [assessor] such information as the state [tax commissioner *or other official*] shall require, including classification information prepared for the applicant's land or water bodies used in agricultural production by the soil and water conservation district office within the county, and information demonstrating the eligibility for agricultural assessment of any land used in conjunction with rented land.
 2. Such application shall be filed with the county [assessor] on or before the appropriate taxable status date.
 3. If an applicant rents land from another for use in conjunction with the applicant's land for the production for sale of crops, livestock or livestock products, the gross sales value of such products produced on such rented land shall be added to the gross sales value of such products produced on the land of the applicant for purposes of determining eligibility for an agricultural assessment on the land of the applicant.
- (b) Land for which an agricultural assessment is sought:
1. shall have been devoted exclusively to agricultural production, or devoted to or qualified for payments or other compensation from a federal land retirement or conservation program, for the previous three years;
 2. shall have produced an average yearly gross income of at least \$[5,000] during that previous three-year period; and
 3. shall total at least [40] acres, provided, however, that two or more contiguous parcels of land may be combined to meet this minimum area requirement if they are in common ownership or if they are owned separately by members of the same family.
- (c) The application shall include a covenant by the owner, binding on the owner and the owner's successors or assignees and running with the land, that the land shall be kept in agricultural use for a period of [9] years from the date of application. Such

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covenant shall be recorded with the county [recorder of deeds *or equivalent official*] within [15] days of the approval of the application.

- (d) If the county [assessor] is satisfied that the application meets the requirements of this Section and that the applicant is entitled to an agricultural assessment, the [assessor] shall approve the application and the land shall be assessed pursuant to this Section.
1. Not less than ten days prior to the date for hearing complaints in relation to assessments, the [assessor] shall mail to each applicant, who has included with the application at least one self-addressed, pre-paid envelope, a notice of the approval or denial of the application. Such notice shall be on a form prescribed by the state [tax commissioner *or other official*] which shall indicate the manner in which the total assessed value is apportioned among the various portions of the property subject to agricultural assessment and those other portions of the property not eligible for agricultural assessment as determined for the tentative assessment roll and the latest final assessment roll.
 2. Failure to mail any such notice or failure of the owner to receive the same shall not prevent the levy, collection and enforcement of the payment of the taxes on such real property.
- (e) The county [assessor] shall keep a record of all land in the county that is within an agricultural district and that has been granted an agricultural assessment pursuant to this Section.
- (f) Any time after [90] days before an agricultural assessment is due to terminate, the owner of land in the agricultural district that has been granted an agricultural assessment may file a renewal application to continue the agricultural assessment of that land for a period of [9] years.
1. The requirements for continuation of the agricultural assessment and the renewal application procedure shall be the same as those required for the original application for agricultural assessment. An application for renewal of an agricultural assessment shall be denied on the grounds of the imminent termination of the agricultural district only where the district is due to terminate within one year.
 2. The county [assessor] shall notify owners of land granted an agricultural assessment within [90] days of the termination of the agricultural assessment of the necessity of filing a renewal application to continue valuing the land at agricultural use value. If the owner has not filed a renewal application within [30] days of the termination of the agricultural assessment, the [assessor] shall forthwith notify such owner by certified mail that unless a renewal application is filed within the next [15] days, the

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land will be removed from agricultural assessment upon its termination date.

3. An approved renewal application is effective on the termination date of the preceding agricultural district. Failure of an owner to file a renewal application within [15] days preceding the termination of the owner's agricultural assessment shall not prevent the owner from filing an application for an agricultural assessment.
- (g) Land that is transferred to a new owner during the period in which the land is in an agricultural district and has been granted an agricultural assessment shall continue to receive the agricultural assessment unless the new owner elects to discontinue agricultural use of the land and files the election with the county [assessor] within sixty days after the transfer. Failure of the new owner to continue agricultural use for the duration of the period specified in the covenant is subject to the payments and penalties required by paragraph (9) below.
- (8) All land within an agricultural district that has been granted an agricultural assessment pursuant to this Section shall be valued solely with reference to its appropriate agricultural classification and value. In determining the value for ad valorem tax purposes, the county [assessor] shall not consider any added value resulting from nonagricultural factors. [*Add other language specifying the manner in which agricultural value is to be determined as appropriate.*]
- (9) (a) Except as provided in subparagraph (9)(f) below, if land within an agricultural district which received an agricultural assessment is converted to nonagricultural use before the end of the duration of the covenant, it shall be subject to payments equaling:
1. [five] times the taxes saved in the last year in which the land benefitted from an agricultural assessment;
 2. any uncollected special assessments; and
 3. interest of [6] percent per year on the above, compounded annually for each year in which an agricultural assessment was granted, not exceeding five years.
- (b) The amount of taxes saved for the last year in which the land benefitted from an agricultural assessment shall be determined by applying the applicable tax rates to the excess amount of assessed valuation of such land over its agricultural assessment as set forth on the last assessment roll which indicates such an excess.
1. If only a portion of a parcel as described on the assessment roll is converted, the assessor shall apportion the assessment and agricultural assessment

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- attributable to the converted portion, as determined for the last assessment roll for which the assessment of such portion exceeded its agricultural assessment.
2. The difference between the apportioned assessment and the apportioned agricultural assessment shall be the amount upon which payments shall be determined.
 3. Payments shall be added by or on behalf of each taxing jurisdiction to the taxes and special assessments levied on the assessment roll prepared on the basis of the first taxable status date on which the assessor considers the land to have been converted; provided, however, that no payments shall be imposed if the last assessment roll upon which the property benefitted from an agricultural assessment, was more than five years prior to the year for which the assessment roll upon which payments would otherwise be levied is prepared.
- (c) Whenever a conversion to nonagricultural use occurs, the landowner shall notify the county assessor in writing within [90] days of the date such conversion is commenced. If the landowner fails to make such notification within the [90]-day period, the assessor shall impose a penalty on behalf of the assessing unit of up to two times the total payments owed, but not to exceed a maximum total penalty of \$[500] in addition to any payments owed.
- (d) A county [assessor] who determines that there is liability for payments and any penalties assessed pursuant to subparagraph (a) above shall notify the landowner by mail of such liability at least ten days prior to the date for hearing complaints in relation to assessments. Such notice shall indicate the property to which payments apply and describe how the payments shall be determined. Failure to provide such notice shall not affect the levy, collection or enforcement or payment of payments.
- (e) Liability for payments shall be subject to administrative and judicial review as provided by law for review of assessments.
- (f) Land that is deemed converted to nonagricultural use by:
1. action of eminent domain by a governmental unit;
 2. termination of the agricultural district;
 3. denial of an application for agricultural assessment, or for renewal of agricultural assessment, on the grounds of imminent termination of the agricultural district; or

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4. removal from the agricultural district by action of the local governmental that established the district;

shall not liable for payments and penalties under this paragraph, and the covenant may be terminated by the owner at any time after the conversion by filing a document to that effect with the county [recorder of deeds *or equivalent official*].

- (10) (a) No governmental unit with authority to levy special assessments on real property shall collect an assessment for purposes of:

1. sewer, water, or streetlight systems,
2. sidewalks, or
3. [other];

on real property that is within an agricultural district and that is subject to an agricultural assessment pursuant to this Section without the permission of the owner, except that any assessment may be collected on a lot surrounding a dwelling or other structure not used in agricultural production that does not exceed one acre.

- (b) For each special assessment levied for the purposes described in subparagraph (10)(a) by a governmental unit on real property within an agricultural district, the county assessor shall make and maintain a list showing:

1. the name of the owner of each parcel of land that is exempt from the collection of the special assessment under this Section;
2. a description of the exempt land;
3. the purpose of the special assessment; and
4. the amount of the uncollected assessment on the exempt land.

The recording of the assessments does not permit the collection of the assessments until such time as exempt lands are converted to nonagricultural use.

- (11) Except as provided in this paragraph, no entity possessing power of eminent domain under the laws of this state, whether a governmental unit or a corporation, shall acquire any land or easements having a gross area greater than [10] acres in size within agricultural districts. Except as provided in this paragraph, no governmental unit shall advance public funds, whether by grant, loan, interest subsidy, or otherwise, within an agricultural district for the construction of nonfarm housing, or commercial or industrial facilities to serve nonagricultural uses of land.

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- (a) At least [60] days prior to such an acquisition or advance, notice of intent shall be filed with the director of the [department of agriculture] containing information and in the manner and form required by the director. The notice of intent shall contain a report explaining the proposed action, including an evaluation of alternatives which would not require acquisition or advance within agricultural districts.
- (b) The director, in consultation with affected units of government, shall review the proposed action to determine the effect of the action on the preservation and enhancement of agriculture and agricultural resources within agricultural districts and the relationship to local and regional comprehensive plans.
- (c) If the director finds that the proposed action might have an unreasonable effect on an agricultural district, the director shall issue an order within the [60]-day period for the party to desist from such action for an additional [60]-day period.
- (d) During the additional [60]-day period, the director shall hold a public hearing concerning the proposed action at a place within the affected agricultural district or otherwise easily accessible to the agricultural district. The director shall provide notice of the hearing within [30] but not less than [15] days before the hearing:
 - 1. in a newspaper having a general circulation within the area of the agricultural district;
 - 2. in writing delivered by mail, to the local governments whose territory encompasses the agricultural district;
 - 3. in writing delivered by mail, to the entity proposing to take the action; and
 - 4. in writing delivered by mail, to any governmental unit having the power of review or approval of the action.
- (e) The review process required by this paragraph may be conducted jointly with any other environmental impact review required by law.
- (f) The director shall be empowered to suspend for up to [1] year any eminent domain action which he or she determines to be contrary to the purposes of this Section and for which he or she determines there are feasible and prudent alternatives which have less negative impact on agricultural districts.
- (g) The director may request the attorney general to bring a civil action to enjoin any governmental unit or corporation from violating the provisions of this paragraph.
- (h) This paragraph shall not apply to:

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1. any utility facilities, including, but not limited to, electric transmission or distribution facilities or lines, facilities used for exploration, production, storage, transmission, or distribution of natural gas, synthetic gas, or oil, or telephone lines and telecommunications facilities; or
 2. any emergency project that is immediately necessary for the protection of life and property.
- (12) Except as provided in this Section, a local government shall be prohibited from enacting or enforcing land development regulations, or other ordinances or regulations, within an agricultural district that would, as adopted or applied, unreasonably restrict or regulate normal farm structures or agricultural use or practices, unless the restriction or regulation bears a direct relationship to an immediate and substantial threat to the public health or safety. This prohibition shall apply to the operation of farm vehicles and machinery, the type of farming, and the design of farm structures, exclusive of residences.
- (13) In a civil action for nuisance involving agricultural activities, it is a complete defense if:
- (a) the agricultural activities were conducted within an agricultural district;
 - (b) agricultural activities were established within the agricultural district prior to the plaintiff's activities or interest on which the action is based;
 - (c) the plaintiff was not involved in agricultural production; and
 - (d) the agricultural activities were not in conflict with federal, state, and local laws and rules relating to the alleged nuisance or with generally accepted agriculture practices.

The plaintiff may offer proof of a violation independently of any proof of violation or conviction provided by any public official.

NOTE 14 – A NOTE ON ELEMENTARY AND SECONDARY PUBLIC SCHOOL FINANCE AND ITS RELATION TO PLANNING

**By Michael Addonizio, Associate Professor of Education,
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Local land-use planning decisions affect public schools and school finance in several ways. First, these local decisions influence the location, construction, and reuse of school buildings. Local comprehensive plans include population projections that can be used to identify the growth in school age populations. These plans also include locational criteria for school sites. Further, local comprehensive plans may identify schools that need rehabilitation or closing and reuse of the

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building or site. School closings and school building demolitions are particularly controversial. In many communities, public schools are centers of community activity and symbols of community identity. School buildings may have historical or architectural significance.

A second connection between land use and public schools involves the approval of school facility construction. Such approval is often given through a conditional use permit issued by a local government (e.g., planning commission, board of zoning appeals, or legislative body) following a public hearing.

Finally, because local governments rely on the property tax (and, to a lesser extent, sales tax) to finance local public services, including schools, they often design their land use controls to attract “good ratables;” that is, those types of land use that raise a lot of property tax revenue while creating little need for additional public services. Examples include commercial and industrial facilities and expensive single-family homes. At the same time, land use for “bad ratables” that generate little tax revenue and substantial demand for public services (for example, low- and moderate-cost housing) is often discouraged.¹⁷⁰

An inevitable result of this local competition for “good ratables” is the enormous disparities in the fiscal capacity of local communities to support public education. That is, new investment will seek those local communities with great taxable wealth and correspondingly low tax rates, while low-wealth communities struggle with high rates to finance basic services, including public schools. In view of the importance we attach to education in preparing our children for citizenship and economic participation, such disparities seem unfair and undemocratic. These concerns, which have been the subject of considerable political and judicial activity, have led states to pursue school funding systems that seek to neutralize these disparities.

This research note summarizes the development of contemporary law and policy governing the financing of public elementary and secondary schools in the United States. The note examines the workings of the basic models and methods used by states to fund both school operations and capital projects and analyzes landmark litigation that gave rise to these state programs. As such, this note is intended to be a concise reference for policymakers at all levels of government, including governors and legislators, their staffs, and other state and local officials with responsibilities related to a wide array of public issues, including planning, economic development, housing, transportation, community revitalization, and the environment. Clearly, the quality of our public school systems is a matter of paramount importance to the public and their elected and appointed leaders. An understanding of the financing of those systems may inform our work in other parts of the public sector.

SCHOOL FINANCE: A BRIEF HISTORY

The idea of free, tax-supported schools did not gain stature in the United States until the nineteenth century. American schools began as local entities, largely private and religious during

¹⁷⁰Norman Williams, Jr., “Halting the Race for ‘Good Ratables’ and Other Issues in Planning Legislation Reform,” in *Modernizing State Planning Statutes: The Growing SmartSM Working Papers, Vol. 1*, Planning Advisory Service Report 462 (Chicago: American Planning Association, 1996): 57-61.

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the seventeenth, eighteenth and early nineteenth centuries. As in England, educating children was considered a private matter, the responsibility of families, not government. The eighteenth century leaders of the new republic considered education as a means to prepare citizens to actively participate in democratic government and exercise the liberties guaranteed by the Constitution. However, while Thomas Jefferson advocated the creation of free elementary schools, his proposal was not adopted on a statewide basis until the mid-nineteenth century, when Horace Mann and Henry Barnard, state superintendents of Massachusetts and Connecticut, respectively, led efforts to establish publicly-supported “common schools.”¹⁷¹

From the mid-seventeenth through mid-eighteenth centuries, one-room elementary common schools were established in local communities, generally supported by a small local tax. Each locality operated independently, since there were no state laws or rules governing public education. At the same time, several large school systems evolved in the big cities of most states. As early as the seventeenth century, these local educational systems reflected differences in the local ability to support them. Big cities were generally quite wealthy, while the small, rural systems were quite poor and had great difficulty supporting a one-room school.

As the number of local school systems grew and education came to be viewed as an essential unifying force for the growing republic, political and educational leaders sought to establish state educational systems. By 1820, 12 of the then 23 states had constitutional provisions, and 17 had statutory provisions, regarding education. In some states, new constitutional articles not only mandated the creation of statewide systems of public education, but assigned government responsibility for the financing of public schools.

The creation of state-controlled and publicly financed “common schools” raised many fundamental issues of school finance, including the relative roles of state and local government in supporting public schools and whether funding levels should be substantial and at least roughly equal across local districts. Specifically, questions arose regarding the meaning of new constitutional phrases such as “general and uniform,” “thorough and efficient,” “basic,” or “adequate,” words and phrases appearing in the education clauses of many state constitutions. Did such language require equal per pupil spending for every pupil in the state or merely a basic educational program for every child, with local per pupil spending determined locally? These issues persist today and have been resolved in different ways across the states.

In the mid-to-late 1800s, most states required local school districts to fund their public schools entirely with local property taxes. At the same time, however, when states determined local district boundaries, the districts often varied enormously in their local property wealth per pupil and, thus, in their ability to raise school revenue. Property-rich districts were able to support relatively high

¹⁷¹Government financing of schools began in Massachusetts in 1647, when the state’s General Court passed the famous Old Deluder Satan Act, which required every town to set up a school or pay a sum of money to a larger town to support education. The act required towns with at least 50 families to appoint a teacher of reading and writing, and required towns with more than 100 families to also establish a secondary school. The Act required that these schools be supported by masters, parents, or local citizens, thereby providing for the financing of schools through local taxation. The first local property tax for schools was levied in Dedham, Massachusetts, in 1648. John D. Pulliam, *History of Education in America*, 4th ed. (Columbus, Ohio: Merrill, 1987).

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per pupil spending with relatively low tax rates while the opposite was true for property-poor communities. School finance policy throughout the twentieth century has attempted to address these fiscal inequities. While some writers and policymakers focused on local spending differences *per se*,¹⁷² most policy debate addressed the dependence of local school revenue on local property wealth.¹⁷³

(1) *Flat Grant Programs*. By the mid-nineteenth century, the inequities arising from locally-financed public schools, including the inability of some poor localities to finance any public school, led states to provide a lump-sum or flat grant, usually on a per school basis, to help support their local elementary school. However, while this approach guaranteed every locality some resources for public schools (including those that raised no local resources) and increased overall support for public schools, the flat-grant approach made no distinction among districts; rich and poor alike all received equal state support.

As school enrollments grew, states increased their levels of support and changed from school-based to classroom, and eventually pupil-based or teacher-based grant formulas. By the turn of the century, the dramatic growth of public school enrollments had rendered flat grant formulas very expensive and required substantial state payments to relatively affluent communities. Consequently, rising levels of state school aid failed to measurably reduce the funding inequities in states with local districts of varying levels of per pupil property wealth.

(2) *Foundation Programs*. As the shortcomings of flat-grant aid formulas became evermore apparent by the start of the twentieth century, researchers and policymakers sought a more effective way to reduce inequities in public school finance. An ingenious solution was devised by George Strayer and Roger Haig, professors at Columbia University, whose proposed formula would come to dominate public school finance throughout the twentieth century.

The Strayer-Haig (or “minimum”) foundation program was designed to assure all local districts of a level of resources sufficient to provide an educational program of minimally acceptable quality. Flat grants failed in this regard because of their low levels resulting from the spread of state aid across all local districts, rich and poor alike. The foundation formula solved this problem by financing the per pupil spending target through a combination of state and local revenue. That is, the foundation program requires the levy of a minimum local tax rate as a condition of receiving state aid. The required tax rate is applied to the local tax base. The state foundation grant is equal to the difference between the state’s foundation per pupil revenue level and the local per pupil revenue raised by the required tax rate.

The genius of the Strayer-Haig foundation formula is its substitution of local revenue for state aid in relatively wealthy districts, thereby allowing greater state support for property poor districts. This substitution allowed for a substantial increase in minimum per pupil spending over flat-grant

¹⁷²A. Wise, *Rich Schools–Poor Schools: A Study of Equal Educational Opportunity* (Chicago: University of Chicago Press, 1969).

¹⁷³J. Coons, W. Club, and S. Sugarman, *Private Wealth and Public Education* (Cambridge, Mass.: Belknap Press of Harvard University Press, 1970).

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formula levels and emphasized the importance of a coordinated state and local partnership in funding public schools. Thus, a foundation aid formula has several attractive attributes. First, it finances a minimum educational program in every district. Second, it provides general aid in inverse relation to local district property wealth (that is, the formula equalizes local fiscal capacity). Third, it requires a local contribution.¹⁷⁴

At the time of its introduction in the early twentieth century, the foundation program was a major policy innovation that enabled states to implement a finance system that could substantially improve educational programs in the previously lowest-spending districts. That is, even the poorest of districts could offer at least a minimally adequate educational program. In 1986-87, 30 states had a foundation funding structure¹⁷⁵ and by 1993-94 the number had risen to 40.¹⁷⁶

The current popularity of the foundation approach evolved with progress in education research, judicial challenges to state school finance structures, and state legislation. The next section will examine major judicial and legislative reforms that have shaped the landscape of our current school finance systems.

¹⁷⁴As noted by Odden and Picus, states have differed in their approach to the local contribution. Though most districts levy a tax rate at or above the minimum required local rate, a few do not. A policy issue for states is whether to impose the minimum rate on such districts or reduce their state foundation aid. The difficulty with such draconian state measures arises from the fact that many of these low-tax districts are also quite poor, with low property wealth and low income. Generally, states have not enforced the minimum tax in these districts. Rather, some states (e.g., New York and Michigan) make full foundation aid payments to districts regardless of local tax effort. In this way, low-tax districts sustain only a local revenue loss. Other states (e.g., Texas) reduce state foundation aid in the same proportion that the local tax rate falls below the designated minimum rate. See A. Odden and L. Picus, *School Finance: A Policy Perspective*, 2d ed. (Boston: McGraw Hill, 2000).

¹⁷⁵Richard Salmon, Christina Dawson, Stephen Lawton, and Thomas Johns, *Public School Finance Programs of the United States and Canada: 1986-87* (Sarasota, FL: American Education Finance Association, 1988).

¹⁷⁶Steven D. Gold, David M. Smith, and Stephen Lawton, *Public School Finance Programs of the United States and Canada: 1993-94* (New York: Center for the Study of the States, the Nelson A. Rockefeller Institute of Government, and the American Education Finance Association, 1995). In a widely-heralded school finance reform effort, Michigan adopted a foundation funding system in 1994-95. For an analysis of this reform, see M. Addonizio, C.P. Kearney, and H.J. Prince, "Michigan's High Wire Act," *Journal of Education Finance* 20 (Winter 1995): 235-269.

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MODERN REFORMS IN SCHOOL FINANCE DUE TO LITIGATION

Differences across local school districts in per pupil expenditures, generally arising from differences in local taxable wealth, have been a concern for most states for the past century.¹⁷⁷ During this time, issues of equity and adequacy have received much attention from educators and policymakers and became the subject of litigation and resultant finance reforms starting in the late 1960s. In this policy area, equity refers to the elimination or diminution of the relationship between local wealth and local per pupil spending, while adequacy refers to the availability in every local district of per pupil spending that is sufficient to bring students to minimally acceptable levels of achievement. Such levels are generally established by the state.

Contemporary school finance litigation dates back to the late 1960s, when suits were filed in Illinois and Virginia challenging the constitutionality of spending differences across local districts.¹⁷⁸ In each case, plaintiffs argued that the finance systems were unconstitutional because education was a fundamental right and the wide differences in local school spending were not related to differences in educational need. Rather, spending differences arose from differences in local taxable wealth. However, when plaintiffs were unable to provide the court with a standard by which to identify and measure “educational need,” both courts ruled that the suits were non-justiciable and dismissed plaintiffs’ claims. To succeed in future litigation, plaintiffs needed to develop a standard with which the courts could assess plaintiffs’ claims – that state school funding systems failed to meet the requirements of equal protection.

In the late 1960s, Northwestern University law professor John Coons and two students, William Clune and Stephen Sugarman, formulated a theory that local school districts were creations of state government and that by creating a funding system that was heavily dependent on local tax revenue, states were denying local districts equal opportunity to raise school revenue. In so doing, states were creating a suspect classification defined by district per pupil property wealth.¹⁷⁹ By this argument, a state school finance system that resulted in unequal per pupil funding across districts would be subject to “strict judicial scrutiny.” That is, the state would be required to demonstrate a “compelling state interest” for its finance system and that “no less discriminatory” policy is available to the state to serve that compelling interest. When courts invoke this test, states are generally unable to make these demonstrations and, therefore, lose the case.

Coons, Clune, and Sugarman argued that systems of school finance should be “fiscally neutral,” that is, per pupil revenue in a local district should not be related to the wealth of that local district. Rather, it should be related to the wealth of the state as a whole. This standard of fiscal neutrality, moreover, was easily applied. One need only measure the statistical relationship between local per

¹⁷⁷E.P. Cubberly, *School Funds and Their Apportionment* (New York: Teachers College Press, 1905).

¹⁷⁸*McInnis v. Shapiro*, 293 F.Supp. 327 (N.D.Ill.1968), affirmed sub nom. *McInnis v. Ogilvie*, 394 U.S. 322, (1969), and *Burruss v. Wilkerson*, 310 F.Supp. 572 (W.D.Va.1969), affirmed 397 U.S. 44 (1970).

¹⁷⁹J. Coons, W. Clune, and S. Sugarman, *Private Wealth and Public Education* (Cambridge, Mass.: Belknap Press of Harvard University Press, 1970).

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pupil property wealth and local per pupil revenue within the state. Further, as demonstrated below, a fiscally neutral state school finance formula could be devised with relative technical (if not political) ease.

Thus, this new strategy rested upon two arguments: first, that education is a fundamental right and second, that local property wealth per pupil is a suspect class. At the time, neither argument had been accepted by the courts. The second argument was particularly controversial, since the characteristic pertained not to individuals, as all previous suspect classes had, but to a governmental unit.

The first case filed using this strategy was *Serrano v. Priest* in California.¹⁸⁰ The case was filed in 1968 and defendants immediately moved to dismiss, claiming that school finance cases were non-justiciable, and relying on two earlier federal cases, *McInnis v. Shapiro* and *Burrus v. Wilkerson*. The trial court dismissed the case on that basis and plaintiffs appealed to the California Supreme Court. Relying on both the Fourteenth Amendment to the U.S. Constitution and the equal protection clause of the California constitution, the California Supreme Court ruled that: (1) the case was justiciable and the standard of fiscal neutrality applied; (2) education is a fundamental right and property wealth per pupil is a suspect class; and (3) if the facts were as alleged, California's school finance system was unconstitutional. This precedent-setting opinion, rendered in August 1971, commanded national attention and triggered similar court challenges in other states. It also led to California's adoption of a guaranteed tax base (GTB) school aid system, described below.

One landmark case following closely upon *Serrano* was *San Antonio School District v. Rodriguez*¹⁸¹ in Texas. Significantly, this case was filed in federal court and heard initially by a three-judge district court panel. The panel found for the plaintiffs, finding education to be a fundamental right and property wealth per pupil to be a suspect class. Accordingly, the district court ruled that the Texas school finance system violated the equal protection clause of the U.S. Constitution and ordered the legislature to design a constitutional system.

The case was immediately appealed to the U.S. Supreme Court. In March 1973, in a 5-4 decision, the U.S. Supreme Court held that the Texas school finance system did not violate the U.S. Constitution. The majority held that while education was important preparation for citizenship in the U.S., it was not mentioned in the Constitution. The majority also held that property wealth per pupil was not a suspect class because it described governmental units and not individuals. Accordingly, in the absence of a finding of discrimination based either on suspect classifications (e.g., race, gender, national origin) or on the impairment of a fundamental right (i.e., a right expressly or implicitly guaranteed by the U.S. Constitution), the Court invoked the relative lenient rational relationship test. The state successfully responded that its school finance system was related to the principle of local control.

¹⁸⁰*Serrano v. Priest*, 5 Cal.3d 584, 487 P.2d 1241, 96 Cal.Rptr. 601 (1971).

¹⁸¹*San Antonio Independent School District v. Rodriguez*, 411 U.S. 45 (1973), rehearing denied by 411 U.S. 959 (1973).

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The *Rodriguez* decision effectively eliminated the U.S. Constitution as a vehicle for public school finance reform and returned this litigation to state courts. As noted by the *Rodriguez* majority, most state constitutions not only mention education but have clauses explicitly assigning responsibility for providing access to free, public education. School finance reform litigation would now proceed state by state on the basis of state equal protection clauses and state education clauses.

School Finance Challenges in State Courts

Just one month after the *Rodriguez* decision, the New Jersey Supreme Court decided *Robinson v. Cahill*.¹⁸² While acknowledging that education is mentioned in the New Jersey constitution, the court held it is not a fundamental right. Further, while recognizing the existence of wealth-related per pupil spending disparities across local districts, the court held that property wealth per pupil was not a suspect class. Accordingly, the court found that the New Jersey school finance system did not violate the New Jersey equal protection clause.

However, the court did overturn the New Jersey school finance system on the basis of the state constitution's education article, which requires the legislature to "provide for the maintenance and support of a thorough and efficient system of free public schools." Construing the education article as a guarantee for all children of "that educational opportunity...needed in the contemporary setting to equip a child for his role as a citizen and as a competitor in the labor market", the court ruled that "the state must meet that obligation itself or if it chooses to enlist local government it must do so in terms which will fulfill that obligation"¹⁸³ The court concluded the constitutional guarantee had not been met because of the fiscal disparities across school districts.

Robinson was important for three reasons. First, it kept school finance litigation alive after *Rodriguez*. Second, it established a precedent for challenging school finance systems through the "direct application" of state education articles, a substantively different approach than making an equal protection challenge.¹⁸⁴ Third, the case foreshadowed subsequent challenges that came to be known as "adequacy" litigation. These cases expanded the notion of school finance equity beyond finance to the breadth and depth of educational programs provided to all children. Specifically, a key question for the courts in adequacy cases is whether all children have an opportunity to achieve at high levels¹⁸⁵

¹⁸²*Robinson v. Cahill*, 62 N.J. 473, 303 A.2d 273 (1973)

¹⁸³*Id.*, at 63 N.J. 510.

¹⁸⁴The education article of a state constitution may also be invoked by "indirect application," through arguments that the article's language establishes education as a fundamental right with equal protection guarantees requiring strict scrutiny analysis.

¹⁸⁵See Odden and Picus, *supra*.

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A notable direct application of a state education article and a forerunner of the concept of educational “adequacy” as articulated in prominent cases in the 1990s is *Pauley v. Kelley*,¹⁸⁶ in which the West Virginia Supreme Court of Appeals considered the constitutional provision that “the Legislature shall provide, by general law, for a thorough and efficient system of free schools.” The court held that, under equal protection guarantees, any discriminatory classification in state’s educational financing system cannot stand unless state can demonstrate some compelling state interest to justify the unequal classification, and that the “thorough and efficient” clause contained in West Virginia Constitution requires that the state legislature develop certain high quality statewide educational standards; if these values are not being met it must be ascertained that failure is not a result of inefficiency and failure to follow existing school systems. The high court remanded the case to the circuit court with orders to develop “thorough and efficient” education standards.

This case is noteworthy for the detail of the standards (or “Master Plan”) thus developed, including requirements for curriculum, personnel, facilities, and equipment for all school programs, along with the resources needed to meet those standards. The circuit court found the existing systems “woefully inadequate” by comparison and invalidated both the state school finance system and state procedures regarding local property tax assessments. It was not until 1997, however, that a court ordered the state to fully fund the plan.

The adequacy approach to interpreting state education clause requirements matured in the 1990s, with notable cases including Kentucky, Massachusetts, Alabama, and New Jersey. In *Rose v. Council for Better Education, Inc.*¹⁸⁷, the Kentucky Supreme Court considered in 1989 whether the Kentucky General Assembly has complied with its constitutional mandate to “provide an efficient system of common schools throughout the state” Upon reviewing the evidence, the high court concluded that Kentucky’s wide variation in fiscal and educational resources resulted in unequal educational opportunities across local districts. Noting large interdistrict variances in both per-pupil property wealth and curricula, the court also cited resource-related disparities in pupil achievement test scores and expert opinion presented at trial that clearly established a positive correlation between such test scores and district wealth.¹⁸⁸

Guaranteed Tax Base Programs

Guaranteed tax base (GTB) programs were introduced in the early 1970s in response to school finance litigation in California. Like the foundation program, a GTB program is designed to remedy the basic structural flaw in the traditional approach to the local financing of public schools; namely, the unequal distribution of property wealth across local school districts. A GTB program guarantees

¹⁸⁶*Pauley v. Kelley*, 162 W.Va. 672, 255 S.E.2d 859 (1979).

¹⁸⁷*Rose v. Council for Better Education, Inc.*, 790 S.W.2d 186 (1989).

¹⁸⁸Further, in a somewhat unusual turn, the court compared Kentucky’s elementary and secondary education system with national and neighboring norms in terms of fiscal performance and student achievement, finding Kentucky substandard in both instances.

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every local district a minimum per pupil revenue yield for each mill of tax effort. Put another way, a district's per pupil revenue level depends entirely upon its tax effort and not at all upon its tax base, because each district is guaranteed, through state aid grants, the equivalent of a state-designated property tax base.

Guaranteed tax base programs were first enacted in the early 1970s, at the same time of the first successful judicial challenges of state school finance systems. The object of these challenges was the relationship between school revenue and property wealth, stemming from the unequal distribution of local per pupil property wealth. In effect, GTB systems, also known as district power equalizing, guaranteed yield or equal yield systems, seek to guarantee all local districts equal access to school revenue through the local property tax.

In a GTB system, state aid varies inversely with local property wealth per pupil and directly with local tax effort. Districts can raise revenue in exactly the same manner as if they have a local tax base equal to the GTB. Further, unlike the foundation program which assigns determination of the tax rate to the state, the GTB program reserves that important decision to the local district voters. Thus, once local voters determine their desired per pupil spending level, they simply divide that figure by the GTB to determine their local tax rate. Then, they can multiply their local per pupil property wealth by their tax rate to determine their local share of school funding. For example, assume a local district in a state with a GTB program has per pupil property wealth in the amount of \$60,000 and a preferred spending level of \$6,000 per pupil and that the state's GTB is \$120,000. The district's required tax rate would be $6,000/120,000 = 0.05$; that is, 5 percent or 50 mills. Their local per pupil contribution would be $\$60,000 \times .05 = \$3,000$ and their per pupil GTB aid would be $\$(120,000 - 60,000) \times .05 = \$3,000$.

Another important feature of GTB is that both local revenue and state aid increase with increases in the local tax rate. That is, the GTB is a matching grant formula, with a district's matching rate inversely proportional to its per pupil tax base. In the example above, the local district's matching rate is 1.0. That is, for each local dollar raised for schools, the state will contribute one dollar. In the jargon of public finance, the local marginal tax price of a one dollar increase in per pupil spending in this example is fifty cents. Matching formulas, therefore, create an incentive for increasing expenditures on the supported service. This local discretion as to school spending level and the occasional unpredictability of local voter response to the GTB incentive have led many states to reject this funding program.¹⁸⁹

The key question for a state with GTB program is the selection of the per pupil tax base level that the state will guarantee. The ideal level would be, of course, the level enjoyed by the most property rich school district. However, while this would ensure all districts access to the same effective tax base, it is prohibitively expensive. On the other hand, a low tax base guarantee (say, the statewide tax base per pupil) would leave all districts of above-average per pupil taxable wealth

¹⁸⁹The Kalkaska School District in Michigan closed its doors in mid-March of 1993 after local voters defeated a millage renewal. This early school closing, which received national attention, was a critical factor in Michigan's abandonment of GTB and adoption of its current foundation funding system the following year. For a full account and analysis, see Addonizio, Kearney, and Prince *supra*.

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with a fiscal advantage over all the rest. That is, at the same tax rate, these “out-of-formula” districts would be able to raise more per pupil revenue through their local property tax than the “in-formula” districts could raise through a combination of local property tax revenue and state GTB aid. The existence of such “out-of-formula” districts is contrary to the purpose of GTB, which seeks to offset school spending differences that stem from differences in local taxable wealth.

While there are no absolute standards with which states establish their GTB guarantee levels, Odden and Picus point to several possible benchmarks.¹⁹⁰ In states that have defended court challenges to their school finance systems, guarantee levels have been set from the 75th to the 90th percentile of students. A subsidiary issue for GTB states is whether to impose a limit on either the tax rate to be equalized or the local rate, or both. Under the former limit, state GTB aid would be paid up to the designated maximum rate and any local millage levied in excess of that rate would raise only local revenue. The principal weakness of this approach, of course, is that the unequalized portion of the revenue structure could swamp the equalizing effects of the GTB formula. The second type of limit is imposed on the local tax rate, resulting in a cap on per pupil expenditures. While such a limit would detract from local control, it would also limit variation across districts in per pupil expenditures. Kentucky’s 1990 school finance reforms included both of these reforms.

Although the GTB formula is designed with mathematical precision to equalize the tax bases available to local districts, two problems arise with this program. First, as mentioned above, states generally cannot afford to equalize all districts up to the level of the most property-rich communities. Second, even for those districts within reach of the formula, GTB programs often fail to eliminate the link between local school spending and local property wealth. That is, among GTB recipients, those with higher income and property wealth tend to levy higher local school tax rates than their less wealthy counterparts; wealthier voters tend to be more responsive to the price effects of the GTB formula, electing to purchase more of the subsidized good.

Combining Foundation and GTB Programs

Some states combine foundation and GTB programs in an effort to ensure both an adequate funding level in every district and some measure of local discretion about school spending. These combination programs can be viewed as two-tiered, with the first tier consisting of a foundation program and a state-mandated tax and the second tier a GTB program providing local district voters with the option of levying equalized millage in excess of the state mandate.

Missouri has had such a two-tiered program since 1977.¹⁹¹ In that year, the legislature placed a GTB program on top of their pre-existing foundation formula. In 1993, the legislature set the foundation level at just below the previous year’s statewide average expenditure per pupil and the GTB level at the per pupil property wealth of the district at the 95th percentile on that measure.

Combination formulas were also adopted in response to two widely-heralded and successful judicial challenges to school funding system in Texas and Kentucky. In Texas, the 1989-90

¹⁹⁰Odden and Picus, *supra*.

¹⁹¹*Id.*

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foundation program provided all districts with base per pupil revenue equal to 42 percent of the state average per pupil revenue.¹⁹² This relatively low foundation was supplemented by a GTB program that guaranteed every district an effective per pupil tax base just below the statewide average. However, the state limited this guarantee to 3.6 mills over the required foundation tax rate. Districts were also allowed to levy unequalized local millage in excess of this limit.

The Kentucky legislature established a foundation base for 1989-90 equal to about 77 percent of the statewide average.¹⁹³ The legislature also placed a GTB program on top of this foundation, with a guarantee of approximately 150 percent of the state average. Kentucky's GTB program included two tiers, each with a tax rate limit. The first tier limited local districts to a 15 percent increase over the foundation level in revenue per pupil in combined local tax revenue and GTB aid. The second tier allowed local voters to raise up to an additional 15 percent of the foundation level through additional but unequalized millage. Put another way, Kentucky limited local revenue per pupil to 30 percent over the foundation level, with half of this "excess" revenue available through equalized millage.

This combination approach provides a means to meet a state objective of ensuring minimally adequate per pupil spending in all districts while allowing some measure of local discretion about spending above the foundation level- through an equalized local tax. Such local discretion allows districts to respond not only to local preferences regarding educational programs, which generally vary across localities, but also to differences in the price of educational resources, including teacher salaries. Such prices are generally higher in urban districts.

Adjustments to Basic Funding Levels

Odden and Picus cite four types of adjustments that states could reasonably be expected to make to their base per pupil allocations: special pupil needs (e.g., children from poor families, children with physical or mental disabilities, or children with limited English proficiency); education level (elementary and secondary); economies and diseconomies of scale; and price differences, noted above.¹⁹⁴ Of these adjustments, the matter of special pupil needs is arguably the most important and has received far more attention by policymakers than the other issues. The attention stems from the uneven distribution of special needs children across local districts. For example, children from households with incomes below the poverty level tend to be concentrated in large, urban districts and small, generally rural districts. Such districts are also home to concentrations of students from whom English is not the primary language.

¹⁹²Id.

¹⁹³Id.

¹⁹⁴Id.

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Children raised in poverty and children with limited English proficiency have much greater than average risk of not graduating from high school.¹⁹⁵ Accordingly, such students require various types of supplemental educational services. Like regular education services, the cost of supplemental services varies considerably across local districts. Large urban districts generally face higher prices for these services while serving larger concentrations of special needs students. At the same time, such districts are generally property-poor as compared with statewide averages. Consequently, most states and the federal government recognize a responsibility to assist districts in financing these supplementary programs. Such aid, however, is small in comparison to general school revenue and is distributed to local districts according to the numbers of special needs pupils and not local taxable wealth.

NOTABLE STATE SCHOOL FINANCE REFORMS

The foregoing analysis addresses the goals of state school finance systems and the mechanisms designed to achieve them. This section will examine finance reforms in four notable reform states: Kentucky, Texas, Michigan and Vermont. These states addressed issues of taxation and educational funding with bold remedies, some in response to adverse judicial decisions and others in response to political pressures.

(1) *Kentucky*. In 1989, as noted above, the Kentucky Supreme Court ruled that the state's entire elementary and secondary public school system was unconstitutional (*Rose v Council for Basic Education, Inc.*, 790 S.W. 2nd 186 (Ky. 1989)). This landmark decision resulted from an earlier and more limited school finance case in which plaintiffs challenged the constitutionality of the Kentucky funding formula on grounds that it was inequitable and therefore in violation of the education clause of the state constitution, which requires that school funding be "efficient." The district court found for the plaintiffs. On appeal, the Supreme Court expanded the scope of the decision to include not only school finance but the entire public education system and directed the legislature to recreate the entire education structure, including school governance, finance and curriculum.

The finance reform, known as Support Educational Excellence in Kentucky (SEEK), consists of four parts: an "adjusted base guarantee" (ABG), a required local tax effort, and two "tiers" which allow local districts to supplement their basic guarantee through a combination of state and local revenue.¹⁹⁶ The ABG provides local districts with a foundation payment for each student. This base revenue level is set by the General Assembly and is constant across all districts. The base is then adjusted by four factors associated with the costs of special services: services for exceptional children, services for educationally at-risk children (generally, low-income), pupil transportation and home and hospital instruction. The minimum local tax effort required for the ABG grant is 30 cents per \$100 of assessed valuation. Tier I provides local districts with an option to supplement their

¹⁹⁵H. Levin, "The Economics of Education for At-Risk Students," in *Essays in the Economics of Education*, E. Hoffman, ed. (Kalamazoo, Mich.: W.E. Upjohn Institute for Employment Research, 34-73).

¹⁹⁶For a more complete discussion of SEEK, see J.E. Adams and W.E. White, "The Equity Consequence of School Finance Reform in Kentucky," *Educational Evaluation and Policy Analysis* 19 (1997): 165-184.

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ABGs by a maximum of 15 percent. School boards may levy taxes and the state matches this local effort with equalization aid for districts with property wealth per pupil below 150 percent of the state average. Tier II allows school districts to raise up to 30 percent of combined ABG and Tier I revenue. Local levies permitted under Tier II must be voted by the local electorate and are not equalized by the state.¹⁹⁷

Kentucky's Office of Education Accountability reports that total state and local support for K-12 education rose from about \$2 billion in 1989-90 to \$3.4 billion in 1997-98, an increase of 70 percent. Per pupil revenue rose from \$3,161 to \$5,306 over this period, an increase of nearly 68 percent. At the same time, school funding has become more equitable, with the difference between mean per-pupil revenues in the highest and lowest quintiles falling from \$1,516 in 1989-90 to \$209 in 1997-98, a decrease of 86 percent. Similarly, the coefficient of variation fell from 0.193 in 1989-90 to 0.090 in 1996-97, indicating that two-thirds of all pupils in Kentucky were within 9 percent of the statewide average per pupil revenue.¹⁹⁸

(2) *Texas*.¹⁹⁹ Public school funding in Texas has been shaped by a series of lawsuits filed in the state courts over the 1985 to 1995 period.²⁰⁰ At issue in this litigation was the heavy reliance on local property taxes to fund public schools and the great disparity in property values across the state. These wealth disparities had to be neutralized by the state in order to provide local districts with equal access to school revenue. The litigation prompted the Texas legislature to pass a system of aid formulas that comprise the Foundation School Program (FSP). The FSP equalizes funding for public education in Texas by supplementing local school revenue with state aid and by limiting school funding in very wealthy districts. As such, the FSP provides substantially equal revenue per pupil at equal local tax rates.

Tier 1, or the foundation, of the FSP provides each local district with a "basic allotment" that is then adjusted to reflect differences in costs and educational needs. State aid under Tier 1 is inversely related to local property wealth per student. The resulting combination of state and local funds provides local districts with equal levels of educational resources for equal tax effort. To participate in this program, local districts are required to levy a "Local Fund Assignment" tax rate of \$0.86 per \$100 of property value.

¹⁹⁷In 1996-97, 161 of Kentucky's 176 school districts participated in Tier I at the maximum level, while the remaining 15 participated to some degree. In addition, 161 districts participated in Tier II to some extent. Office of Educational Accountability, *1997 Annual Report* (Frankfort, Ky.: Kentucky General Assembly, 1997).

¹⁹⁸J.E. Adams, "Kentucky: A Decade Since *Rose*," in *The Political Economy of Education: The State of the States and Provinces 1999*, B. Brendt., ed. (Rochester, N.Y.: University of Rochester, 1999), 77-82.

¹⁹⁹This section draws on C. Clark, "Introduction to Texas School Finance," in *The Political Economy of Education: The State of the States and Provinces 1999*, B. Brent, ed. (Rochester, N.Y.: University of Rochester, 1999), 197-202.

²⁰⁰*Edgewood Independent School District v. Kirby*, 777 S.W. 2d 391 (Tex. 1989); *Edgewood v. Meno*, 917 S.W. 2d 717 (Tex. 1995).

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Tier 2 provides equalization funds to local districts in excess of the base funding level of Tier 1. Unlike Tier 1, participation in this program is discretionary. Districts may levy up to \$0.64 of tax per \$100 of property value and will be guaranteed \$21 per student for each penny of tax rate in combined state and local funds. Districts with per student property wealth in excess of \$210,000 will receive no state aid.

A third part of the funding structure provides for so-called “wealth sharing.” Specifically, districts with property values greater than \$280,000 per pupil are required by Chapter 41 of the Texas Education Code to reduce their wealth by one of five wealth sharing options. These options include school district consolidation, detachment of property and annexation of that property to a low-wealth district, purchase of attendance credits from the state, contracting for the education of students in another school district, and consolidation with lower wealth districts. Of the 93 districts subject to the Chapter 41 wealth sharing provisions in 1998-99, all chose either the purchase of attendance credits or contracting for the education of nonresident school districts. These measures, commonly referred to as “Robin Hood” requirements, have combined with Tiers 1 and 2 to measurably improve the equity of public school funding in Texas.

(3) *Michigan*. Prior to 1973-74, Michigan distributed general aid to local schools through a foundation aid system that guaranteed a minimum expenditure per pupil in every local district. However, by 1973, Michigan’s highest-spending district tripled the per-pupil expenditures of the state’s poorest district. Facing disparities of this magnitude, along with a court challenge of the constitutionality of Michigan’s aid system,²⁰¹ the legislature replaced the foundation formula with a guaranteed tax base (GTB) formula, effective for the 1973-74 fiscal year. In that first year, more than 90 percent of Michigan’s school districts received GTB aid. By 1993-94, however, this percentage had fallen to approximately two-thirds and the ratio of per student spending between the highest- and lowest-spending districts had risen to the levels of the early 1970s. Further, property tax rates had risen to unacceptably high levels for many residents and 122 districts were within four mills of the state’s constitutional 50-mill limit.

Voter ambivalence toward Michigan’s property tax and school funding systems was reflected in a string of 12 consecutive failed statewide ballot proposals spanning more than a decade in the 1980s and early 1990s. Then, in late July of 1993, in a stunning development, the Michigan legislature eliminated the local property tax as a source of operating revenue for the public schools, thereby lowering K-12 operating revenue by more than \$6.5 billion. In March of 1994, Michigan voters approved a constitutional amendment (Proposal A) increasing the state sales tax from 4 to 6 percent. In addition, the state’s flat rate income tax was lowered from 4.6 to 4.4 percent, the cigarette tax was raised from 25 to 75 cents per pack, and a per-parcel cap on assessment growth was set at the lesser of inflation or five percent (reassessed at 50 percent of market value on sale). Property taxes for school operations were restored at dramatically lower levels than before – to six mills on homestead property and 24 mills on non-homestead property in most districts.

²⁰¹*Milliken v. Green*, 389 Mich. 1, 203 N.W. 2d 457 (1972), opinion vacated by 390 Mich. 389, 212 N.W.2d 711 (1973).

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On the allocation side, new legislation returned Michigan from a GTB formula to a foundation program as the core of state school funding. A district's 1993-94 combined state and local operating revenue per pupil (primarily local property taxes, state aid and most categorical aid) formed the basis for determining its 1994-95 foundation allowance. The legislation provided that every district have a foundation of at least \$4,200 per pupil. In addition to establishing a minimum (local) foundation allowance, the legislation set a state basic foundation allowance at \$5,000 per pupil for 1994-95. This allowance is changed annually through application of revenue growth and enrollment growth indices. Districts spending more than the state foundation will receive per-pupil revenue increases equal to the annual dollar increase in the basic foundation allowance, while districts spending less than the basic allowance will receive increases up to twice that amount. Thus, this basic allowance, which rose to \$5,153 in 1995-96, \$5,308, \$5,462 in 1997-98 and 1998-99 and \$5,696 in 1999-00, will constrain per pupil spending growth in more districts each year and exert a "range preserving" effect on interdistrict spending disparities.²⁰²

Michigan's school finance reforms were intended to achieve four objectives: (1) substantially reduce property taxes; (2) increase the state share of total K-12 revenue; (3) reduce interdistrict disparities in per-pupil revenue; and (4) assure all local districts a minimum level of resources with which to meet state and local education standards. It appears that the first two objectives have been accomplished. Proposal A reduced total property taxes by about 26 percent. For homeowners, the reduction is about 32 percent, while the cut for businesses is about 13 percent. Further, the state share of K-12 revenue has risen from about 45 percent in 1993-94 to over 80 percent in 1999-2000. Measurable progress has also been made toward objective three.²⁰³

Progress toward objective four, however, is more problematic. While the reforms established minimum funding levels for local districts and substantially increased aggregate K-12 revenue in 1994-95, including proportionately large increases for low-spending districts, aggregate revenue growth has slowed since then. With new constraints on local revenue growth and a greater reliance on more income-elastic revenue sources, overall real spending levels could fall during a recession. Centralization and equalization of public school funding along the lines of the Michigan reforms have led to slower revenue growth in other states.²⁰⁴

(4) *Vermont*. In February 1997, the Vermont State Supreme Court unanimously ruled that the state's school finance system was unconstitutional.²⁰⁵ Prior to the ruling, Vermont's public school

²⁰²For a detailed analysis of the Michigan foundation program and related reforms, see M. Addonizio, C.P. Kearney, and H.J. Prince, "Michigan's High Wire Act," *Journal of Education Finance* 20 (Winter 1995): 235-269.

²⁰³M. Addonizio, "You Can't Always Get What You Want: Property Tax Relief and School Funding in Michigan," in *The Political Economy of Education: The State of the States and Provinces 1999*, B. Brendt., ed. (Rochester, N.Y.: University of Rochester, 1999), 111-116.

²⁰⁴See, e.g., T. Downes, "Evaluating the Impact of School Tax Reform on the Provision of Public Education: The California Case," *National Tax Journal* 45 (December 1992), 405-419.

²⁰⁵*Brigham v. State of Vermont*, 166 Vt. 246, 629 A.2d 384 (1997).

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finance system was characterized by large disparities in local tax burdens and per pupil expenditures. Local school tax rates ranged from \$0.02 to \$2.40 per \$100 valuation, while per pupil spending varied from \$2,961 to \$7,726. The court held that state's system of financing public education did not satisfy requirements of education clause and the common benefits clause of Vermont Constitution; these clauses, said the supreme court, require the state to ensure substantial, rather than absolute equality of educational opportunity throughout Vermont. Equal per pupil funding, the court ruled, was neither a constitutional requirement nor a desired policy goal. Rather, the court held that a constitutional funding system required that educational opportunity not be a function of local wealth.

In response to this ruling, the legislature passed Act 60, which established a two-tiered funding formula consisting of a foundation program at its base and a guaranteed tax base (GTB) program as a supplement. The foundation level was set at \$5,010 per pupil and indexed to the cost of government goods and services, while the GTB was set for FY 2000 at \$40 per pupil for each 1 cent increase per \$100 valuation in the local property tax. The program is funded by a new statewide property tax set at \$1.11 per \$100 valuation in FY 1999. The system includes a controversial redistributive mechanism, or “recapture” provision, whereby property-rich towns that generate local revenues in excess of either the foundation level with the statewide tax or the GTB level with the local tax pay these excess funds to the state. These funds are then redistributed to districts statewide. Both the tax and expenditure features of the new system have been roundly criticized by residents of property-rich districts, some of whom have experienced a doubling or tripling of their school taxes while facing lower growth in per pupil revenue.²⁰⁶

FINANCING CAPITAL PROJECTS²⁰⁷

Local school districts are generally unable to finance the construction of new facilities, renovation of older buildings or the acquisition of large equipment (e.g., buses, technology) from operating revenue. Rather, they need authority to sell bonds to spread payments over a long period. At the same time, states regulate such borrowing to ensure the responsible use of this debt and prevent defaults or large, long-term deficits.

While most states provide modest financial assistance to their local districts for capital projects, most long-term debt is repaid with local property tax revenue. Consequently, the quality of public school facilities often depends upon local district fiscal capacity, precisely the equity problem addressed in *Serrano* and other cases with respect to school operating revenues. State responses to this equity issue, have been decidedly less substantial regarding capital outlay. As Alexander and Salmon have observed: “The problems of providing modern school plants, not only in the ghetto

²⁰⁶W.J. Mathis, “The State of the State: Vermont’s Act 60 Finance Reform,” in *The Political Economy of Education: The State of the States and Provinces 1999*, B. Brendt., ed. (Rochester, N.Y.: University of Rochester, 1999), 209-212.

²⁰⁷This section is based, in part, on a more complete discussion in K. Alexander and R.G. Salmon, *Public School Finance* (Needham Heights, Mass.: Allyn and Bacon, 1995).

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areas of cities but also in many rural and metropolitan area school districts, cannot be resolved until appropriate new designs, provisions, and procedures for financial support are developed and implemented.”²⁰⁸

Although states have adopted a variety of state capital-outlay and debt-service-assistance programs, the tradition of local financing of public school facilities continues in most states today. Given the limited funds available from state-supported capital-outlay and debt-service programs, local districts rely on one or more of the following three options:

(1) *Current revenues*. Some very large or very affluent school districts are able to finance school construction projects on a “pay-as-you-go” basis. By this method, the entire cost of a project is accrued from the revenues of one fiscal year’s local tax levy. This method is ideal because it eliminates costs associated with interest payments, bond attorney fees, and local tax elections. Two disadvantages are the failure to distribute capital costs over those future generations that will benefit from the facility and the failure to capitalize on lower real borrowing costs during periods of inflation. In any event, few local districts are able to finance large capital projects with current revenues.

(2) *Building Reserve Funds*. Some states permit local districts to accumulate tax revenues for the purpose of funding the construction of future school facilities. These building reserve funds are kept separate from current operating revenues and are generally raised through earmarked tax levies. In most cases, state laws limit the investment of these revenues to low-risk, low-yield options. Building reserve funds enable a local district to undertake a capital project without the delays and costs associated with obtaining voter approval for the sale of the bonds. In addition, debt service costs are avoided as are local restrictions on tax or debt limitations.²⁰⁹ Such funds are used by several states but raise a relatively insignificant proportion of K-12 capital funding.²¹⁰

(3) *General Obligation Bonds*. The vast majority of public school facilities is financed through the sale of general obligation bonds. School bonds, along with other municipal bonds, are legal instruments sold by the borrower as evidence of debt, which specify interest rates, payment schedules, and security. Municipal bonds are exempt from the federal personal income tax and the personal income tax in most states, making them particularly attractive for investors facing high marginal income tax rates.

Municipal bonds are a relatively low-risk investment. Moreover, general obligation bonds (one type of municipal bond) are secured by the full faith, credit and taxing authority of the issuer. As such, general obligation bonds are usually considered the most secure of the municipal bonds.

Constraints imposed on the issuance of general obligation bonds vary considerably across the states and, in some cases, across local school districts within states. Most states limit local school

²⁰⁸Id., at 335.

²⁰⁹K. F. Jordan, M. McKeown, R. D. Web, *School Business Administration* (Newbury Park, Calif.: Corwin Press, 1985), 272-278.

²¹⁰K. Alexander and R.G. Salmon, *supra*, at 337.

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district debt, a constraint that is particularly troublesome for property-poor districts. States also impose various requirements on local districts seeking approval of the sale of general obligation bonds. Some states require a simple majority of those voting at referendum, while others require a supermajority.

State Options for Capital Expenditure Financing

By 1993-94, 35 states provided financial support to local districts for capital expenditures.²¹¹ This support was provided through one of the following mechanisms: (1) complete state support; (2) grants-in-aid; (3) loans; or (4) building authorities. Each is discussed briefly below.

(1) *Complete State Support.* Under this option, the funding of all capital and debt-service expenditures of the public schools is borne entirely by the state. One obvious advantage of this approach is statewide fiscal equalization across local districts of varying property wealth. Further, states generally have access to a greater variety and level of resources than do local units of government and face lower borrowing costs. Such programs, however, are rare. In 1993-94, complete-state-support programs were operating in Alaska, California, and Hawaii.²¹²

(2) *Grants-in-aid.* Such grants generally take one of three forms. *Equalization grants* are designed to allocate aid in inverse relation to local district property wealth per pupil. This approach, which is widely used by states to distribute operating revenue to local school districts, allows local districts to finance school facilities of comparable quality despite variations in local taxable wealth. Further, these grants require some local contribution, creating an incentive for greater efficiency in capital spending. *Percentage-matching grants* provide a fixed percentage of state support for each local capital project. Unlike equalization grants, these grants do not vary with local fiscal capacity. This approach is viewed by critics as overly burdensome to property-poor districts where voters may need to levy high local tax rates in order to obtain the required local matching funds. Consequently, states have abandoned this approach, with its last proponent, Delaware, changing to an equalization approach in 1992. *Flat grants* provide local districts with a fixed amount of revenue for each state-approved capital project or each pupil. In either case, this approach shares with percentage-equalizing grants the drawback of ignoring local district fiscal capacity. The adverse consequences become greater, of course, when the flat grant aid is a small proportion of total capital spending.

(3) *Loans.* Some states have established one or more funds, often through the use of earmarked revenues, with which to provide low-interest loans to local districts. In most cases, these loan programs do not consider the relative fiscal capacities of local districts and thus, do not achieve any significant degree of fiscal equalization.

(4) *Building Authorities.* Public school building authorities are agencies established by the state to allow local districts to circumvent restrictive tax or debt limitations otherwise imposed on local

²¹¹*Public School Finance Programs of the United States and Canada*, Steven D. Gold, David M. Smith and Stephen B. Lawton, eds. (Albany, NY: American Education Finance Association and Center for the Study of the States, The Nelson A. Rockefeller Institute of Government, State University of New York, 1995), 48-52.

²¹²*Id.*

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governments. Since these authorities are separate government agencies and do not operate schools, tax or debt limitations for the school district are thereby averted. Not all states permit the use of building authorities to construct school facilities. Often, local school districts can use building authorities without obtaining local voter approval. These authorities, however, generally suffer the disadvantage of using revenue bonds to finance capital projects, thereby incurring higher interest costs as compared with the interest costs of more secure general-obligation bonds.

Site Selection and Acquisition

Acquiring a proper site for a school is a critically important public service. However, obtaining good sites for schools is becoming increasingly difficult.²¹³ Problems in site acquisition include competition for sites with the commercial sector; the increase in site size to accommodate a widening range of educational programs; the rise in land prices; and, in urban areas, the scarcity of open land. As a result, education planners now must consider less than optimal sites. Further, while communities want a new school when enrollments rise sufficiently, no one wants a new school located next to their property. Reasons include noise and congestion and the perception that an adjacent school site will lower property values.

The selection of a school site is one of the most controversial issues involved in planning a new school. Consequently, some local school officials choose not to involve members of the community in the site selection process. This is particularly true in large districts, where local school politics can be particularly contentious. In a survey of the ten largest school districts in the country, respondents in a majority of the districts indicated they do not include local residents in the location decision for fear that disagreements could delay or prevent site acquisition.²¹⁴ Resort to such a closed decision-making process, however, is not universal. Many local districts, as a matter of policy, involve community members in the site selection process. Participants in this process analyze data and information from several sources, including regional, urban or community land use maps, aerial photographs, re-development authority maps, and a tour of the areas to be served by the new school.²¹⁵

The final criterion for school site selection is political acceptability. In more heavily populated areas, a school site is usually designated well in advance of need by the local governing body in accordance with their long-range development plan. Such a plan generally addresses the placement of all important community resources, including schools, recreation areas, parks, libraries and other amenities intended to serve the entire community.²¹⁶

Impact Fees

²¹³G.I. Earthman, "Facility Planning and Management," in *Principles of School Business Management* (Reston, Va.: Association of School Business Officials International, 1986), 611-649.

²¹⁴G.I. Earthman and J. Bailey, "The Politics of Site Selection," *CEFP Journal* 13, No. 5 (October 1975): 4-8.

²¹⁵G.I. Earthman, *supra*.

²¹⁶*Id.*

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Local governments across the U.S. have adopted various forms of impact or developer charges as a means of financing the timely installation of public facilities, including public schools. These charges imposed as a condition of development approval include impact fees, special assessments, development agreements, user fees and connection fees. Impact fees are imposed on developers to ensure sufficient funding for those capital services and facilities needed to support the new development. Such public services and facilities include roads, parks, police, fire, sewer, water, libraries, and schools. Some states expressly authorize impact fees for schools.²¹⁷

CONCLUSION

Local school districts across the U.S. vary enormously in income and property wealth. Fueled in large part by local land use decisions and other economic development measures designed to attract investments, these local fiscal disparities pose a challenge to education policymakers and others who seek equal educational opportunities for our children. Such opportunities can arise only through the workings of state school finance structures that effectively neutralize the often substantial differences in local school district fiscal capacity. The structures have been shaped, in large part, by judicial decisions about states' constitutional responsibilities for funding public schools.

Following the landmark U.S. Supreme Court decision in *San Antonio Independent School District v. Rodriguez*, which effectively closed the door on education finance equity litigation in the federal courts, reform advocates have turned to state courts and legislatures to pursue equity and adequacy in public school finance. These reforms seek to neutralize differences in property wealth across local communities. Without such state intervention, children fortunate enough to live in wealthy enclaves will have access to a rich array of educational resources while those in poor communities will face relatively meager school programs. In view of the importance attached to education in preparing our children for participation in public and economic life, such a situation seems unfair and undemocratic.

In response to these concerns, states have adopted school funding structures designed to offset differences in local property wealth. These structures, which are much more prominent in the funding of school operations than school construction and rehabilitation, provide state school aid in inverse proportion to local taxable wealth. Guaranteed tax base (GTB) and conceptually equivalent district power equalizing programs allow local voters to determine their tax and school spending levels and seek to assure local districts equal revenue per pupil for equal tax effort. In contrast, foundation programs limit local voters' ability to exceed those rates. Some states employ a combination of these two approaches.

While these state initiatives have succeeded in measurably improving the equity of school funding across the states, funding disparities remain as local economic development proceeds unevenly across communities. As long as local governments vary in their abilities to attract high

²¹⁷See the discussion of state impact fee enabling statutes preceding Section 8-602 (Development Impact Fees) of the *Legislative Guidebook*. See generally C.L. Siemon and M.J. Zimet, "School Funding in the 1990s: Impact Fees or Bake Sales," *Land Use Law and Zoning Digest* 44, No. 7 (July 1992): 3-9.

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value commercial, industrial and residential investment, their capacities to support public education systems will vary as well. As a result, the task of achieving equal educational opportunity for our children will remain a responsibility of the states.