



Key Funding & Finance Options for Local Transportation Investments

Local and regional entities are doing more with less as we ask them to be centers for economic growth and continued prosperity for the nation. Communities across the country are stepping up efforts to maintain their existing infrastructure and prepare for future demands on their transportation systems. Local leaders in these communities are best able to identify the particular transportation investments needed to address their community’s unique challenges. Since the turn of the 21st century, local governments have dramatically increased their commitment to our transportation systems by increasing revenues to meet demands.

It is important to give these communities and local leaders the tools and resources to invest in the transportation solutions that are critical to their economic competitiveness. Through the consolidation of programs in MAP-21, many discretionary programs that communities looked to are not there anymore to help them advance their transportation solutions. Formula programs now make up nearly 93 percent of all Federal highway funding, an increase of 10 percent over SAFETEA-LU. Furthermore, local and regional entities are provided less than 15 percent of all authorized highway funds from MAP-21. In short, funding and project selection has been streamlined in a way that only a select few determine how Federal funds are spent, in some instances, largely ignoring the needs of local governments both large and small.

Additionally, the primary source of funding for local transportation projects, the Surface Transportation Program (STP), had more than \$5.0 billion of new responsibilities added to it by MAP-21; however, STP funding was increased only \$1.2 billion.

While local options are increasingly important in making projects happen, the federal and state governments will continue to have important roles to play in supporting the construction, expansion, and operations of local transportation infrastructure. Local and regional success in the years to come will only be possible with a continued strong partnership with states and the federal government.

| MAP-21 Highway Programs | Funding (billions) | Percentage of MAP-21 Funds |
|--|--------------------|----------------------------|
| National Highway Performance Programs (NHPP) | \$21.8 | 58.6% |
| Surface Transportation Program (STP) | \$10.0 | 26.9% |
| <i>*STP Suballocation for Local and Regional Control</i> | \$5.0 | 13.4% |
| Highway Safety Improvement Program (HSIP) | \$2.4 | 6.5% |
| Congestion Mitigation Air Quality (CMAQ) | \$2.2 | 5.9% |
| Transportation Alternatives (TA) | \$0.8 | 2.2% |
| <i>*TA Suballocation for Local and Regional Control</i> | \$.04 | 1.1% |

Filling the Gap: Local Revenues & Bonds

Building a new transportation project typically requires sponsors to combine multiple sources of funding (grants or money that does not have to be repaid) and financing (debt or money that must be repaid). As evident in the research completed by T4America, governments have a wide range of revenue options,

such as sales taxes, special assessments, local option income taxes, tax increment financing, and property taxes. These revenues can be applied directly to project costs or used to as a repayment stream either for municipal bonds or private investment. Innovative financing is one way to assemble a complete funding package—especially when a local jurisdiction can generate long-term locally controlled revenue.

Local Revenue Sources

In order to access financing options and to compete effectively for federal and state grant programs, local revenues need to be raised. Debts have to be repaid and federal programs reward applicants with a strong local financial commitment (also referred to as local match).

Local funds typically originate from a limited number of common taxes and fees. Each potential tax and fee has its own unique benefits and trade-offs that this chapter will discuss in detail.

When debating the merits of a particular revenue strategy, four considerations are critical:

Revenue Yield: Will the tax generate enough revenue to make debt service payments?

Reliability: Is the tax susceptible to cyclical fluctuation or sudden changes?

Equity: Does the tax unfairly burden certain residents or businesses?

Political Feasibility: Can the tax generate sufficient political support from elected officials and key stakeholders?

A successful revenue strategy will combine those tax and fee options that produce sufficient money to support project financial obligation and also hold together a local political coalition. The revenue options outlined in this section are some of the most common and robust.

Property Tax – General : The property tax is the oldest tax levied in the United States and is the only major tax common to all fifty states. It is also a mainstay of municipal and county revenue structures, although fifteen states still levy the tax to garner state revenue. This tax is levied on a property owner who pays a percentage of the value of his property. 'Property' is a broad category which includes real, personal, and state-assessed property. Real property is immobile and includes residential and commercial land, natural resources and fixed improvements to the land. Personal property is mobile and includes both tangible (i.e. vehicles and equipment) and intangible (stocks, bonds and bank accounts) items. State-assessed property includes public utilities and railroads, which span several local jurisdictions.

Revenue Yield: Assessing a property's value, generally defined as 'fair market value,' is an inexact science; the total value of a parcel of land plus the property on it is estimated using legally specified standards applied by a tax assessor. While assessors in most states are part of county government, New England states usually employ municipal assessors, and Maryland is unique in its use of state assessors. The assessed value remains until the property is exchanged on the market where its actual market value is determined, or until it is reappraised. Real property is reappraised periodically, but most states have no statutory requirements requiring their frequency. For the states that require regular appraisal, the frequencies range from every two years to every ten.

Reliability: Land Values tend to be stable over time, providing predictable revenues

Political Feasibility: Restrictions are in place in many states to increasing the general property tax levy. Where allowed, these are new taxes and land owners need to understand the benefits offered.

Property Tax - Tax Increment Financing (TIF): Tax increment financing is a way of applying the additional property tax revenue generated by the surrounding land after a project is completed. Tax increment financing does not involve a tax rate increase. Instead, the rise in property values resulting from the transportation project generates additional revenues that are dedicated to making payments on debt, for the transit project or supportive projects. Tax increment funds are set aside from properties within a defined geographic zone around the project for as long as necessary to close out project debts.

Property taxes are typically expressed as a certain number of dollars per \$100 of assessed value. For instance, at \$2 per \$100 of assessed value, a \$375,000 business property would owe \$7,500 in property taxes each year. If the value of the same property rose to \$500,000, after the transit project was completed, the property tax liability would rise by \$2,500 to \$10,000 in total. The \$2,500 increase in property tax revenue would be dedicated to covering construction costs or making debt service payments.

Revenue Yield: The revenue yield from tax increment financing is highly variable. In part, the amount of revenue generated depends on the geographic size of the TIF district. Moreover, the extent to which local planners work with developers to facilitate new real estate development also greatly impacts property tax receipts. Tax increment financing is an important source of revenue, but will likely not be the only source for your project. As discussed above, in some cases, tax increment revenue can be pledged to support a Tax Increment Bond, or a local government can agree to provide capital funds for a project based in part on its expected increase in revenue in future years.

Reliability: Property values tend to be relatively stable over time, providing a degree of predictability.

Equity: The benefit of tax increment financing is that it connects project financing with those property owners who benefit directly from the new system and it is considered less regressive than a sales tax.

Political Feasibility: Because TIF is not a new tax, it usually does not encounter the political opposition that other sources of revenue might. Still, tax increment financing may raise concerns that a new project is diverting money that would otherwise flow to other public services.

Additional Resources

Center for Transit Oriented Development: Capturing the Value of Transit
<http://www.reconnectingamerica.org/assets/Uploads/ctodvalcapture110508v2.pdf>

Property Tax - Special Assessment District: A special assessment district is another form of property tax. The properties located within a defined zone around the transportation project are assessed with a higher tax rate or a flat fee expressly to fund amenities that benefit those properties. A special assessment district may levy the additional taxes or fees based on distance from the project, type of land use, total acreage, or frontage along the transit line. Special assessments are typically structured to generate either a specified level of revenue or to last a set number of years.

Revenue Yield: The revenue yield from a special assessment district can be substantial. Typically, an assessment district is applied to a highly developed portion of the metropolitan area or an area with significant planned development. The developed land has high property values that can generate significant revenue.

Reliability: Property values tend to be stable or rise over time, providing a high degree of predictability.

Equity: The benefit of a special assessment district is that it connects project financing with those property owners that directly benefit from the new system.

Political Feasibility: Because special assessments are levied on specific parcels they are a highly visible form of taxation that may prove more politically challenging than a diffuse revenue stream such as a sales tax. Moreover, special assessment districts are a new tax.

Sales Tax: A sales tax is a broad-based revenue source capable of generating substantial revenue due to the large volume of transactions that happen each year. In many states, the legislature must enact an enabling statute that provides local jurisdictions the authority to impose a dedicated sales tax to support transit. The taxing jurisdiction has the flexibility to determine applicability or scope of the sales tax (i.e., the types of goods and services to which the tax will apply). This flexibility allows the taxing jurisdiction to address concerns over equity. For instance, local officials may decide to exclude food, medicine, and other essential goods from the sales tax. In many cases these “local-option” sales taxes must receive voter approval.

Revenue Yield: Sales taxes can generate robust revenues— especially when levied on a region-wide basis.

Reliability: Sales tax transactions are a relatively stable source of revenue (though they are typically not as stable as property taxes). The recent economic downturn has substantially affected sales tax receipts.

Equity: Sales taxes are sometimes critiqued as being regressive because they take a higher percentage of income for individuals further down the earnings scale. Equity concerns may be addressed by exempting certain basic products from sales taxes.

Political Feasibility: The political feasibility of a sales tax depends on many factors. In part, a regional sales tax should be connected to transportation projects that bring regional benefits. Building support for a sales tax, which often requires voter approval, requires a well-designed campaign and time. It also requires a well-defined set of projects and benefits that voters can connect to. Initiatives that meet those criteria often meet with voter approval.

Vehicle Assessment or Registration Fees:

Traditionally, states collect vehicle registration and annual license or tag fees. In addition, some states allow city and county governments the option of imposing an annual assessment based on the value of the vehicle. Local vehicle taxes may also support transit capital projects.

Revenue Yield: Vehicle registration fees are the second most common (and robust) source of transportation revenues at the state level. A number of states are now authorizing local jurisdictions to pursue this revenue source.

Reliability: Vehicle ownership and registration rates are stable.

Equity: Registration fees are typically a flat percentage of vehicle value. Thus, owners of older vehicles have a lower total tax liability than owners of newer models.

Political Feasibility: Political fights over vehicle registration fees are more common than some of the other revenue sources discussed in this chapter. Some states do not permit local jurisdictions to levy vehicle registration fees. Some states also have statutory or constitutional limitations that limit the use of vehicle registration fees only to road projects.

Fuel Tax: For decades, states have funded a large portion of their transportation expenditures with motor fuel taxes. Some states allow city and county governments to tax fuel either on a per gallon basis or through sales taxes.

Revenue Yield: The United States consumed more than 134 billion gallons of gasoline in 2011. Moreover, states also raise the majority of their transportation revenues from gas taxes. Fuel taxes—depending on the tax rate—are a robust but declining source of revenue.

Reliability: Historically, fuel consumption has been a stable, growing source of revenue. Recently, with total driving on the decline and more fuel-efficient vehicles, the future of gas taxes at all levels of government is less certain.

Equity: Fuel taxes, like all flat taxes or fees, are regressive, meaning they represent a higher percentage of income for individuals further down the earnings scale.

Political Feasibility: Fuel taxes are a well-established revenue mechanism, though not all states permit local jurisdictions to levy fuel taxes. Increasing gas prices make raising gas taxes a difficult political lift.

Income Tax: The local option income tax is a flat-rate or sliding scale tax on earned income (including wages, salaries, tips and commissions) from individuals residing in a local jurisdiction, earned income from those who work in the jurisdiction (sometimes referred to as a "commuter tax") and net profits from unincorporated businesses. According to the Tax Foundation, income tax rates range from 0 percent in South Carolina to 11 percent in Hawai'i and Oregon. Some states require state authorization for municipalities to collect the income tax. Adoption of an income tax is more likely in cities than in counties, and some municipalities elect not to levy the tax even when their state authorizes them to do so, as is the case in Arkansas and Georgia. Only Maryland requires income tax adoption by all its municipalities.

Revenue Yield: Income taxes are highly variable and depend on how progressive the income tax structure is in the local jurisdiction

Reliability: Income taxes are volatile, typically corresponding to the state of the local economy

Equity: Fuel taxes, like all flat taxes or fees, are regressive, meaning they represent a higher percentage of income for individuals further down the earnings scale.

Political Feasibility: Local option income taxes are infrequently considered. They are only an option in states with a statewide income tax. Passage is more likely in states with highly progressive

Local Financing

Bonds are the basic way that governments—and government-created entities—borrow money. State and local bonds are often simply referred to as municipal bonds or “munis.” Bonds allow local governments to finance large infrastructure projects that would not be possible within the limitations of annual budgets.

By issuing a bond, a public project sponsor can spread costs over many years for projects that typically last far longer. In return for lending the government money by purchasing a bond, investors receive a specified rate of return or interest payment.

The interest paid by the public entity issuing the bond determines the “cost of funds.” A lower interest bond allows a project sponsor to access capital more cheaply than a high interest bond. The risk of default (i.e., failing to pay bondholders back what they are owed) governs the rate of interest that a project sponsor must offer to attract investors. Interest rates follow a rule: the greater the risk that a bondholder will not be repaid, the higher the interest rate required to attract investors.

Local governments can take steps to make their bonds more secure and attractive to investors. In return for reducing the risk of default, the project sponsor is able to offer a bond with a lower interest rate. For instance, a local government may lower risk to investors by issuing a bond with insurance. If the local government is unable to pay, the insurance company repays bondholders.

When building a funding package for a project, it is important to balance risk and cost. The mixture of grants, loans, bonds, and other financial tools should expose the project sponsor to an acceptable level of risk at the lowest possible cost.

General Obligation Bonds:

General obligation bonds are secured by and repaid from the general tax revenues of the borrowing government. The government issuing the bond pledges its full faith and credit to investors. In effect, the government is promising to use its full powers of taxation to generate enough revenue to repay bondholders. The strength of the full faith and credit pledge makes general obligation bonds a low-risk investment. In exchange for the security that comes from such a powerful pledge, investors are willing to accept a lower interest rate.

Benefits: The principal benefit of issuing a general obligation bond for a project sponsor is its low cost compared to other financing options. Even a modest increase in the interest rate on a bond can add millions of dollars to total project costs. The savings that result from low-cost financing may make the difference between successfully implementing a project and failing to move forward.

Drawbacks: General obligation bonds represent a promise to repay investors before making any other budgetary expenditure. This is a significant risk to the government project sponsor. If tax revenues fall below projected levels, the government must still repay bondholders. As a result, other programs and projects may be at risk of being cut or eliminated. Finally, most governments are limited in how much general obligation debt they may take on. Choosing to offer a general obligation bond may limit the ability of the government to pursue other projects in the future.

Bottom Line: The decision to offer a general obligation bond should include an in-depth analysis of its potential budgetary impacts. The lower borrowing costs associated with a general obligation bond should be balanced against the additional budgetary risks.

Additional Resources:

Federal Highway Administration (FHWA): Project Finance Primer
www.fhwa.dot.gov/ipd/pdfs/finance/ProjectFinancePrimerREV4.pdf

Municipal Securities Resource Board
<http://emma.msrb.org/EducationCenter/EducationCenter.aspx>

Revenue Bonds: Revenue bonds are repaid from a specific source of funds. The creditworthiness of a revenue bond is determined by the strength of the specific source of funds pledged toward repayment. Bondholders do not have a general claim to government revenues. Instead, they have a claim only to those revenues pledged to retire the bond. Generally, revenue bonds are treated as a riskier investment than a general obligation bond due to the narrow repayment pledge. As a result, revenue bonds often require a higher interest rate to attract investors.

Benefits: Revenue bonds are attractive to the project sponsors who are borrowing money because they represent a lower level of budgetary risk than a general obligation bond. In addition, many infrastructure projects generate revenue that may be pledged to repay bondholders.

For instance, if a local government wanted to finance the construction of a parking deck, it could offer a revenue bond that pledged to repay investors with the resulting parking fees. In this case, the local government is not pledging its full faith and credit. Bondholders are entitled to the revenues generated by the project and nothing more.

Drawbacks: Revenue bonds have a higher long-term cost for project sponsors than general obligation bonds due to the higher risk of default, which requires them to offer a higher interest rate.

Bottom Line: The decision to issue a revenue bond is driven by two main considerations: the strength of the revenue source (either generated by the project or a separate source such as a sales tax) and the desire to limit the budgetary risk to other programs and projects. A project with uncertain revenue generating potential that receives a lower credit rating (requiring a high interest rate to attract investors) may not be able to generate enough to pay a higher interest rate.

Tax Increment Bonds: Tax increment bonds (sometimes known as tax allocation bonds) are a form of revenue bond that takes advantage of the increased property tax revenues that result from the transportation investment. For example, transit projects can often increase surrounding land values and serve as a catalyst for new real estate development. As new residential and business projects are built around the transit line, the assessed value of land rises and property tax revenues increase. The increase in property taxes is dedicated to making payments to bondholders.

Benefits: Tax increment financing captures the expected benefits of a transit project in a way that helps get the project built today. Also, by only pledging incremental revenues, it can reassure people that existing revenue sources already being used for other needs will not be tapped.

Drawbacks: Tax increment bonds rely on significant new development to occur around transit stations and within the corridor. Because the potential real estate development may slow, the anticipated increase in revenues may not materialize. These bonds can require a project sponsor to pay a higher interest rate than general obligation bonds. Also, the amount of money generated this way is usually less than a regional sales tax or other broad-based tax measure.

Bottom Line: In order for tax increment bonds to be successful and receive a high bond rating, local leaders, planners, and developers must think critically about how to maximize development potential around stations and within the corridor. This cooperative partnership should begin as early as possible. Also, tax increment financing can cover a portion of project costs, but is not likely to provide full project funding.

Local transportation funding: revenue sources and financing tools

| Revenue sources | Amount | Reliability | Equity | Political feasibility |
|--|---|--|--|---|
| Property tax - general | Variable depending on the tax rate applied to the properties | Land values tend to be stable over time, providing predictable revenues | General property taxes are regressive | Moderate - restrictions are in place in many states to increasing the general property tax levy. Where allowed, these are new taxes and landowners need to understand the benefits offered. |
| Property tax - tax increment | Variable depending on the size of the tax increment district boundary around the transit facility | Land values tend to be stable over time providing predictable revenues | Tax increment revenues tie project benefits (increased land values) to funding the transit project | High—tax increment is not a new tax or a tax increase |
| Property tax - special assessment district | Variable depending on the size of the district and the tax rate applied to properties | Land values tend to be stable over time providing predictable revenues | Ties project funding to taxes levied on surrounding landowners who are direct beneficiaries | Moderate—these are new taxes and land owners need to understand the connection between a new project and the benefits it will bring |
| Sales tax | Sales taxes are broad-based and generate robust revenue | Sales taxes are a little less stable than property taxes but still provide a great deal of predictability | Sales taxes are regressive— although this may be addressed by exempting certain items such as food | High—sales taxes are typically politically successful when the projects they fund brings regional benefits |
| Vehicle registration tax | Moderate | Vehicle ownership rates are stable | Regressive like all other flat taxes | Moderate—vehicle owners are sensitive to registration fees |
| Fuel tax | Robust | Driving rates are historically steady (subject to increasing fuel efficiency standards and recent changes in driving patterns) | Regressive like all other flat taxes | Moderate—high fuel prices make new taxes difficult and not all local governments have the authority to impose a fuel tax |
| Income tax - local option | Variable depending on the amount of income taxed | Income taxes are volatile, typically corresponding to the state of the local economy. | Income taxes are typically progressive | Moderate - local option income taxes typically require a statewide income tax. Passage is more likely in states with highly progressive tax brackets. |
| Financing tools | Repayment | Cost/Risk | Benefit | Drawback |
| General Obligation Bonds | Full faith and credit of government | Typically lower risk and lower interest rates | Lower interest rate can save millions in total financing costs | Budgetary risk to project sponsor if tax collections are lower than expected |
| Revenue Bonds | Specific revenue source (e.g., sales tax, property taxes, user fees) | Typically a higher risk to investors resulting in a higher interest rate | Lower budgetary risk - investors have no claim on general tax collections | Higher interest rates raise the cost of building a project |

