TIFs, MIDs, RIDs, CDDs, SSRBs:
THE ALPHABET SOUP OF
DEVELOPMENT FINANCING INCENTIVES

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Introduction.

South Carolina law provides several methods to finance the costs of capital improvements associated with residential, commercial, industrial, and mixed-use development. Often called "public-private partnerships," these financings require the cooperation of local governments with private developers in order to achieve mutually beneficial goals for the public sector and the private sector. Depending upon the sources of funds and the types of capital improvements to be financed, one or more of these statutory tools can be an important component in the successful development of a project.

All of the incentives discussed below have several features in common. With limited exceptions, they all must be used to fund the costs of property that will ultimately be owned by a public body. It does not necessarily have to be the same public body that will provide the incentive. SSRBs are the primary exception to this requirement of public ownership of the financed improvement; SSRBs can be used to fund the real property component of manufacturing facilities, including buildings and structures owned by the industry.

Regardless of the form of incentive, the improvements that are to be funded are usually infrastructure, such as roads, streets, storm water drainage, water and sewer lines, other utilities, sidewalks, parks and playgrounds, and public parking. But again, there are exceptions as referenced in the previous paragraph for manufacturing facilities.

The incentive generally involves the application of taxes or fees to be paid by the property owner either to pay directly for the infrastructure on a pay-as-you-go basis, or to pay debt service on bonds issued to finance the costs of the infrastructure.

As to credit considerations, there are several recurring themes through the various types of development incentives. Because of the differences among the incentive tools, each has its own distinctive credit concerns and strengths.

<u>The Local Government should Establish Goals and Standards for the Use of Incentives.</u>

Before embarking on the use of these incentives to assist in the development of real property by private sector developers, the local government should establish well-defined goals to be achieved by the use of incentives, and clear standards for their use. An *ad hoc* approach is not good policy. Good policy is one that addresses the constitutional requirement of equal protection under the law and avoids the appearance of favouritism. By establishing standards for the application of development incentives, reliance on individuals by local government is reduced.

A primary legal goal of any policy concerning the use of development incentives should be to advance a public purpose. That is ultimately the requirement for almost any action that is taken by a governmental body. The public purpose can be most clearly met by meeting the legal requirements set forth in the appropriate statute. Although satisfying the statutory requirements is essential to advancing a public purpose of the local government, that should be viewed as a mere threshold endevour, not the conclusion of the local government's inquiry into the use of incentives for a project. Specific statutory requirements in this regard are discussed below for each of the incentives.

Clarify Public Policy

Having determined that the use of the particular incentives can be accomplished through the satisfaction of the statutory requirements, next it is critical that the local government ask the fundamental question: are public incentives appropriate for the project?

The answer to that question cannot be found by reference to statutory requirements or findings. It requires making a number of decisions based on criteria that are tailored to the special needs and circumstances of the local community. By establishing goals to address those special needs or standards to be applied to meet the community's standard's, the local community can most effectively use incentives to advance the well being of the community.

Additionally, by establishing a clear public policy regarding the use of incentives, the local government actually facilitates the use of incentives by developers and industry by taking the mystery out of incentives. Clearly formulated and published goals for the use of incentives will assist potential investors in your community by clarifying their own planning process to determine how incentives might work for their deal.

Some of the goals or standards to be included in the local government's policies could include:

- Minimising the local government's investment.

- Maximising the return on investment (ROI) for the local government.

- Determining that the development would not happen without the incentive.

  For example, prior to creating a TIF district, the county council must find "that private initiative alone are unlikely to alleviate [the blighted, conservation, or sprawl] conditions without substantial public assistance." *S.C. Code Section 31-7-80(A)(7)(a).* Similarly, a city council must find "that private initiatives are unlikely to alleviate these conditions without substantial public assistance." *S.C. Code Section 31-6-80(f)(i).*

- Allowing the developer a reasonable, but not excessive, return on investment (ROI).

  Prior to creating a MIDs district, the local governing body must find that "it would be fair and equitable to finance all or part of the costs of the improvements by an assessment…." *S.C. Code Section 5-37-40(A)(5),* and *S.C. Code Section 6-35-170(B)(5).*

Cost/Benefit Analysis

A common standard that is used by local governments is a Cost Benefit Analysis. That analysis asks the questions:

- What is the local government's investment?

- What is the local government's return on investment (ROI), measured as an increase in jobs, taxes, and intangible spinoffs?

The return on investment to the local government can also be considered in phases. For example, the construction phase can produce:

- Construction jobs.
- Sales taxes.
- Permit fees.
- Recording fees.

The operational phase, depending on the nature of the development, can produce:

- Permanent jobs.
- Real property taxes.
- Personal property taxes.
- State sales taxes, hospitality taxes & accommodations taxes.
- Local option taxes, including local option sales taxes, local hospitality fees & taxes, and local accommodations fees & taxes.
- Parking fees.
- Business license taxes.

Other Standards to Consider

In deliberating whether to proceed or not proceed with the use of incentives, standards to be applied could include:

- The local government's return must be greater than investment.
  This is a statutory requirement for Negotiated FILOT incentives (and, consequently, many SSRBs). *S.C. Code Section 12-44-40(c)* requires a finding by the county council that "the benefits of the project are greater than the costs." (See also *S.C. Code Section 4-12-30(B)(5)(d)* for a similar requirement.)
- The local government must achieve minimum "hurdle rates."
- The developer's return must be reasonable, not excessive.
- Other economic development objectives and criteria specific to the locality.

Applying these standards requires that the local government determine what it is receiving in return for the incentives. It also requires determining the amount of private investment. In other words, is the public incentive adequately leveraging the private investment?

Another commonly used criterion is the "but for" test:

- Do current conditions impair the proposed development?
- Is there some other reason the market acting alone will not produce the development?

  Prior to creating a MIDs district or RID, the local governing body must find that "in the absence of the improvements, property values within the area would be likely to depreciate…." *S.C. Code Section 5-37-40(A)(3)* and *S.C. Code Section 6-35-170(B)(3).*

"But for" the incentives, the projected revenues from the development are insufficient to pay the expenses and debt on the development and provide the developer with a reasonable return. In other words, the local government identifies a need that cannot be supported by the private market. It finds that the private sector is best able to produce the development with public support. The project's "but for" should be clear and demonstrable.

Is the incentive plan economically efficient as compared to the development without the incentives? Sometimes the developer may pursue incentives merely to receive incentives without fully understanding all ramifications of the incentives to the development. And not infrequently, similar results that are sought by both the local government and the developer can be achieved by the use of other incentives (than the one originally requested) that are, perhaps, less controversial or otherwise problematic.

The lack of standards can undermine the local government's credibility in answering to the public. By measuring the results, the process, and the reasons for the incentives against pre-existing standards, the local government is in the strongest position to respond to critics of the use of development incentives. Even when the use of incentives is found to be appropriate, make sure that the programme rationale and plan is conceptually in order before commencing its implementation.

Remember: public services will need to be provided to the development. Will there be sufficient surplus tax revenues (after diverting certain revenues to the incentive) to cover the costs of public services required for the project?

Coordination of Approval Process.

Although it is tempting, especially for local governments that have little experience in providing economic development incentives, to permit the Developer or its professionals to develop, coordinate, and drive the approval process, the procedural process remains a governmental function, for which the local government staff will usually be held

responsible by both the general public and the elected officials. Accordingly, the local government staff should seriously consider maintaining control over the approval process and its schedule.

Because many of the economic development financing tools require the cooperation of other governmental entities (such as the overlapping taxing districts for TIFs and the partner county for multi-county parks and SSRBs), the local government staff needs to coordinate that government –to-government interaction. An incentive package can also require coordination with state economic development staff and boards with whom the local government staff maintains working relations that should facilitate the successful implementation of economic development incentives.

Having developed goals and standards for the use of incentives as described above, the local government will want to control the approval process in order to demonstrate to the public, the application of those standards to the proposed incentive plan. From the public's perspective, it is the local government that should be prepared to show the results, the process followed, and the rationale of implementation that was followed.

Regardless of the type of incentive that the local government chooses to make available to the development, the process should remain in the same order. The process of implementing any of these incentives should be conducted as follows:

- Identify the Opportunity or Project.
- Prepare the Plan (this is discussed below).
- Obtain necessary governmental approvals to be coordinated by the local government staff..
- Close on financing.
- Monitor compliance.

It is best not to get the governmental approval process out ahead of fully developing the Plan, including satisfying the local government's goals and standards, as well as conducting all necessary due diligence. That is when the incentive proposal is ripe for presentation to the public. Despite this fact, there may be immense pressure to do so, as developers tend to take all necessary measures to create momentum in their projects and local government officials may be eager for many reasons to indicate progress in facilitating development.

Know who are likely opponents to the plan, and carefully choose your battles. The local government is likely to be able to identify likely critics of the incentive package, although the developer and local government staff should confer to vet all possible

opposition. Coordination of the approval process is critical in order to address possible opposition.

Having developed standards for the use of economic development incentives, the local government is going to be in a better position to address criticism of the plan because its components will have been measured against objective standards. If portions of the plan need to be modified or even eliminated in order to satisfy legitimate public criticism, the local government is in a better position to evaluate the effect of such changes of the plan on the anticipated public benefits to be derived from its implementation.

Don't Ignore the Risks

Identify the risks associated with the incentive plan and adequately address them in the plan. For example, certain types of development are subject to more risk than others. Multifamily housing projects are generally more cyclical in their sales patterns than single-family homes, and preleasing may be necessary to mitigate office building construction risks. The nature of development risk may introduce varying degrees of speculative characteristics to undeveloped districts owned by one or a few developers. However, credit quality should improve rapidly as development occurs, and homes or commercial development are sold off.

Do not ignore the risks and hope that the best will happen. Identify the risks involved in the incentive plan up front, and take steps to mitigate the potential problems.

Why Would a Developer Pursue Incentives?

Some of the reasons that developers would pursue incentives include:

- High land costs in the market.
- Risk of low sales due to market demographics.
- Local government requires architectural upgrades.
- Higher levels of local government fees.
- Project does not meet required internal rate of return (ROR).

- Project is pursued earlier than planned, or phased in sooner than planned, at the request of local government.

Setting the Stage for the Deal.

Two preliminary steps to the deal have been described above:

- Clarifying Public Policy regarding the use of Economic Development Incentives.
- Coordination of the Approval Process.

The next steps to set the stage for the Deal are those that are necessary for the Preparation of the Incentive Plan. Although the exact nature of that plan, and its associated agreements, ordinances, and resolutions, differ according to which statutory incentive or incentives will be applied to the deal, they all can follow similar steps to development. By adopting a standard template for the identification and negotiation of economic development incentives, the local government staff are in a better position to bring incentive proposals to the local governing body as a matter of routine, as opposed to raising the idea of incentives in an atmosphere of novelty, special circumstances, and, possibly, controversy. That uniform template could be applied as follows:

- Preliminary meeting for the Project.
- Project Review/Financial Analysis.
- Deal Structuring.
- Negotiating a Term Sheet.
- Preparation of the Agreement.

Local Government Due Diligence.

The need to conduct serious due diligence by the local government cannot be over emphasised. The local government should bring its own financial, planning, and legal advisors into the process early. The local government should not rely soley on professionals who are hired by the developer.

A reliable market analysis is almost always necessary to support the use of incentives. A fundamental basis for justifying the use of incentives is that there is a demonstrated market for the development. The market analysis provides the local government the factual basis for providing the incentives.

Review the developer's experience and financial capabilities. The local government should require data that demonstrates the financial history of the developer.

Examine the developer's financing. Discuss it with the developer's banker or other source of financing.

Comparisons with developments in other communities can be very helpful. Identify similar projects to the proposed development and visit them. Discuss those developments with that community's local government staff, developer, and elected officials. Learn from their successes and mistakes.

Review the financial condition of both the local government and the developer before implementing the plan. Incentives can actually compound already existing financial problems of either.

TIFs: Tax Increment Financing.

Tax Increment Financing ("TIF"), sometimes called "tax allocation bonds," is secured by taxes generated from the increase in property values in a TIF district (also known as a "redevelopment project area") after a redevelopment project has begun. Unlike a MID or RID district or special tax district, a TIF district does not raise the property tax rates on TIF district taxpayers, but merely reallocates tax revenues that would otherwise flow to pre-existing taxing entities to the local government that issues the TIF bonds. Under South Carolina statutes, municipalities and counties can create TIF districts. Tax revenues resulting from the property tax values within the TIF district prior to the creation of the district continue to be paid to the overlapping taxing entities as before; only the taxes attributable to the increase in property values are pledged to the TIF bondholders and used for redevelopment project costs or debt service on TIF bonds.

Blighted or Conservation Areas

In order to provide TIF financing, the local government must first establish by ordinance of its governing body a TIF district, known in the South Carolina statutes as a ***"redevelopment project area."*** *S.C. Code Sections 31-6-80 and 31-7-80*. If the TIF district is being established by a municipality, the city or town council must determine that the district is either a ***"blighted area,"*** a ***"conservation area,"*** or an ***"agricultural area"*** meeting certain statutory requirements. This determination is crucial for there to be a "public purpose" served by the use of incentives (instead of merely advancing the developer's private interests) as addressed in the *Wolper* case. If the TIF district is being created by a county government, the county council must determine that the district is

either a ***"blighted area,"*** a ***"conservations area,"*** or a ***"sprawl area."*** These terms are defined in the respective statutes as follows:

"Blighted area" means any improved or vacant area within the boundaries of the TIF district.

(a) if improved, industrial, commercial, and residential buildings or improvements, because of a combination of five or more of the following factors: age, dilapidation; obsolescence; deterioration; illegal use of individual structures; presence of structures below minimum code standards; excessive vacancies; overcrowding of structures and community facilities; lack of necessary transportation infrastructure; presence of or potential environmental hazards; lack of water or wastewater services; inadequate electric, natural gas, or other energy services; lack of modern communications infrastructure; lack of ventilation, light, sanitary or storm drainage facilities; inadequate utilities; excessive land coverage; deleterious land use or layout; depreciation of physical maintenance; lack of community planning; and static of declining land values are detrimental to the public safety, health, morals, or welfare; **or**

(b) if vacant, the sound growth is impaired by:

(i) a combination of two or more of the following factors: obsolete platting of the vacant land; diversity of ownership of such land; tax and special assessment delinquencies of such land; deterioration of structures or site improvements in neighboring areas adjacent to the vacant land; overcrowding of structures and community facilities in neighboring areas adjacent to the vacant land; lack of necessary transportation infrastructure; presence of or potential environmental hazard; lack of water, or wastewater; lack of storm drainage facilities; inadequate electric and natural gas energy services; and lack of modern communications infrastructure; **or**

(ii) the area immediately prior to becoming vacant qualified as a blighted area

"Conservation area" means any improved area or vacant area within the TIF district that is not yet a blighted area where:

(a) if improved, because of a combination of three or more of the following factors: age, dilapidation; obsolescence; deterioration; illegal use of individual structures; presence of structures below minimum code standards; excessive vacancies; overcrowding of structures and community facilities; lack of necessary transportation infrastructure; presence of or potential environmental hazards; lack of water or wastewater services; inadequate electric, natural gas or other energy services; lack of

modern communications infrastructure; lack of ventilation, light, sanitary or storm drainage facilities; inadequate utilities; excessive land coverage; deleterious land use or layout; depreciation of physical maintenance; lack of community planning; and static or declining land values are detrimental to the public safety, health, morals, or welfare;; **or**

(b) if vacant, the sound growth is impaired by a combination of two or more of the following factors: obsolete platting of the vacant land; diversity of ownership of the land; diversity of ownership or the land; tax and special assessment delinquencies on the land; deterioration of structures of site improvements in neighboring areas adjacent to the vacant land; overcrowding of structures and community facilities in neighboring areas adjacent to the vacant land; lack of necessary transportation infrastructure; presence of or potential environmental hazard; lack of water, or wastewater; lack of storm drainage facilities; inadequate electric and natural gas energy services; and lack of modern communications infrastructure; is detrimental to the public safety, health, morals, or welfare and may become a blighted area.

Sprawl or Agricultural Areas

The TIF statutes also permit areas to qualify for TIF financing if they meet the statutory definitions for ***"sprawl area"*** in the case of a county government or an ***"agricultural area"*** in the case of a municipality. These terms are defined in the respective statutes as follows:

"Sprawl area" means a vacant or improved area within the TIF district that is not yet a blighted area nor a conservation area but, because of the existences of one or more of the following conditions, has the potential to become blighted or in need of conservation:

(a) The sprawl area is an unincorporated urban zone, UUZ, which is an area within the unincorporated portion of the county and has a population density equal to or greater than the average population density of the incorporated municipalities within the territorial limits of the county.

(b) The sprawl area is a linear service zone, LSZ, which is an area within the unincorporated portion of the county which is likely to become an area no more than two miles wide at its widest point and no less than three miles in length and which, due to development within the zone, represents an impediment to vehicular and pedestrian traffic so that the county finds its existence a detriment to the:

(i) economic health and well-being of the county;

(ii) health or safety of the persons living, working, or traveling through the zone; or

(iii) efficient provision of governmental services both within and without the zone.

(c) The sprawl area is a rural redevelopment zone, RRZ, which is an area within the unincorporated portion of the county which consists primarily of vacant land which, if provided with certain environmental, energy, transportation, or communications infrastructure, could be developed as a planned community consisting of a minimum of 1,000 contiguous acres of land, inclusive of flooded land or other forms of redevelopment, without regard to minimum acreage requirements, suitable for planned communities, other residential clusters, light industry, tourism and recreation facilities, retail centers, and locations suitable for manufacturing facilities.

"Agricultural area" means any unimproved or vacant area formerly developed and used primarily for agricultural purposes within the TIF district where redevelopment and sound growth is impaired by a combination of three of more of the following factors: obsolete platting of the land; diversity of ownership of the land; tax and special assessment delinquencies on the land; deterioration of structures or site improvements in neighboring areas adjacent to the land; overcrowding of structures and community facilities in neighboring areas adjacent to the land; lack of necessary transportation infrastructure; presence of or potential environmental hazards; lack of water or wastewater; lack of storm drainage facilities; inadequate electric, natural gas or other energy services; lack of modern communications infrastructure; lack of community planning; agricultural foreclosures; and static or declining land values.

Other Determinations Necessary to Create TIF Districts

Additional findings that must be made by the local government in order to create a TIF district include:

- private initiatives are unlikely to alleviate the blight, conservation, agricultural, or sprawl conditions without substantial public assistance (the "but for" test).
- property values in the TIF district would remain static or decline without public intervention (this finding is critical under the *Wolper* case to avoid impairment of contract issues).
- redevelopment is in the interest of the health, safety, and general welfare of the citizens of the local government.

Unlike some of the other incentives discussed below, property owner consent is not a condition to including property in the TIF district.

The Redevelopment Plan

The chief document for the developer to prepare to form the TIF district is a "redevelopment plan." Under South Carolina statutes, the redevelopment plan is the comprehensive plan to reduce or eliminate those conditions which qualified the TIF district as an agricultural area, blighted area, conservation area, sprawl area, or combination thereof, and thereby to enhance the tax base of the TIF district. Each redevelopment plan must set forth in writing the action to be undertaken to accomplish the objectives and must include, but not be limited to, estimated redevelopment project costs including long-term project maintenance, as applicable, the anticipated sources of funds to pay costs, the nature and term of any TIF bonds to be issued, the most recent equalised assessed valuation of the project area, an estimate at to the equalised assessed valuation after redevelopment, and the general land uses to apply in the TIF district.

The preparation of the redevelopment plan addresses the second prong of the public purpose test enunciated by the South Carolina Supreme Court in the *Wolper* case: that the details of the redevelopment plan comply with the public purpose dictates of the TIF statute.

Which Taxing District's Revenues are in the TIF Revenues

The use of TIF districts whose formation pre-dates the 1999 amendments to the statute permits the TIF revenues to be measured (usually) by the millage rates of all the overlapping taxing districts. Since 1999, the consent of the overlapping taxing districts is required in order to include their portion of millage in the TIF revenues. In other words, without the consent of the overlapping taxing districts, only the millage of the local government creating the TIF district can be used to generate TIF revenues.

One drawback to a county TIF district is that if it is annexed by a municipality, only the base assessed value of property in the TIF district is subject to municipal property taxation, not the increased value resulting from the redevelopment project.

Tax increment financing is secured by taxes generated by the increase in property value in a district after a redevelopment project has begun. As such, it does not raise the tax rate on district taxpayers, but merely reallocates tax revenues that would otherwise flow to pre-existing taxing entities in favour of redevelopment project costs or debt service on bonds issued to fund redevelopment project costs. Tax revenues produced from pre-existing property values before the TIF district was created continue to flow through to

the taxing entities as before. Only the taxes attributable to the increase in property values are pledged to pay debt service on the TIF bonds.

Credit Considerations

TIF bonds benefit from several favourable structural elements compared to the other financing incentives discussed in this paper. Unlike special assessment and special tax district bonds, no additional tax burden is created for property owners. Tax collection rates are generally of less concern for a TIF bond, unless TIF district tax payments are concentrated in a few taxpayers.

Although undeveloped land in a special assessment or special tax district can lead to high debt burdens, undeveloped land in a TIF district is generally a favourable factor, since tax revenues will increase to the extent new development occurs and taxable property values grow.

The main credit risk for TIF bonds is that tax rates and the pace of private development in the TIF district are outside of the control of the local government that issues the TIF bonds. Actual tax rates are set by the taxing entities, including the local government that issues the TIF bonds, without consideration of the need to generate sufficient TIF revenues to pay debt service on the TIF bonds. Changes in State tax laws and assessment practices can dramatically influence TIF revenues.

Investment-grade TIF bonds usually have sufficient TIF revenues to cover future maximum annual debt service ("MADS") at the time of the issuance of the TIF bonds. This circumstance is known as "*coverage in the ground*."

Some of the common pitfalls for TIF bonds include volatility in commercial real estate values during an economic downturn, particularly for warehouse and hotel properties. A residential real estate bust would similarly harm TIF bonds. Plant closures can harm TIF bonds for an industrial TIF district. Construction risk for projected development is another pitfall in a TIF financing. Concentration in a few taxpayers is a common problem for TIF bonds. High tax increment volatility ratio for a newly formed TIF district can be problematic.

General economic factors, such as population, employment, building permits, and income levels, are good indicators of the potential for growth in the TIF district.

One weakness of many TIF bonds is the small size of the TIF district, leading to taxpayer concentration. In most circumstances, 150 acres is the minimum size for a viable TIF

district. Taxpayer concentration should be analysed by comparing assessed valuation of the top taxpayers to TIF district incremental value (not TIF district total value).

MIDs: Municipal Improvement Districts.

Special assessment bonds are secured by special assessments imposed on property located in a Municipal Improvement District ("MID") (also known as "CDDs" [Community Development Districts] in some states). The special assessment is generally levied in relation to the benefit a property receives from an improvement project. This determination is critical in order that the assessment can be distinguished from a tax. See the *Livingston* case. Because the assessment is usually not based on the actual value of the property, debt burdens as a percent of the market value of a parcel can vary greatly from parcel to parcel. Because annual assessment payments are usually fixed and cannot be raised to cover the delinquency of any other assessment payer, attention must be given to the exposure due to the weakest properties, even if overall average property value to debt ratios are strong districtwide.

South Carolina has different statutes for county governments and municipal governments to finance public works improvements through the use of special assessments and assessment bonds, and one statute (the Residential Improvement District Act, or "RID") that both municipalities and counties can use. Although they are similar, there are differences among the three statutes.

The three statutes define "improvements" slightly differently, but they all include recreational facilities, pedestrian facilities, sidewalks, storm drains, or water course facilities or improvements, the relocation, construction, widening, and paving of roads and streets, any building or other facilities for public use, including public works eligible for financing pursuant to the Revenue Bond Act for Utilities, and may include the acquisition of necessary easements and land and all things incidental. Affordable housing also qualifies for funding.

One of the more restrictive aspects of these statutes is that they require that all improvements financed by assessments must be owned by the local government, the State, or another public entity for the benefit of the citizens and residents of the improvement district or the entity owning the improvement. This limitation prohibits financing, for example, investor-owned utilities (such as SCANA), private non-profit rural water or sewer companies, and privately-owned landfills.

For a county to initiate the formation of an improvement district, the written consent of the majority of the owners of real property within the proposed district and having an

aggregate assessed value in excess of 66% of the assessed value of all real property within the district, must be submitted to county council. In the case of a municipality, its governing body may initiate the process or it may act upon a petition of the majority of property owners within the proposed district.

For a RID, the approval of all property owners is necessary. Obviously, this requirement limits the utility of this incentive primarily to property before it is developed and subdivided.

It should be noted that a municipality may not include any owner-occupied residential property within the district without the consent of the owner. Of course, if the assessment district is created in cooperation with the developer prior to the sale of any lots, only that developer's consent is required.

There are slight nuances between the findings that a city council must make, as compared to the findings that a county council must make, in order to create a MID. Prior to creating a MID, the city council must find that:

- the proposed improvements would be beneficial within the MID.
- the improvements would preserve or increase property values within the district.
- in the absence of the improvements, property values within the MID would be likely to depreciate, or that the proposed improvements would be likely to encourage development in the MID (the "but for" test).
- the general welfare and tax base of the city would be maintained or likely improved by the creation of the MID.
- it would be fair and equitable to finance all or part of the cost of the improvements by an assessment upon the real property within the MID.

For counties that propose to create a MID, the county council must make findings that:

- the proposed improvements may be beneficial within the MID.
- the improvements may preserve property values within the district.
- in the absence of the improvements, property values within the MID would be likely to depreciate (the "but for" test).
- it would be fair and equitable to finance all or part of the cost of the improvements by an assessment upon the real property within the MID.

Instead of the second and third findings set forth above, the county council may find that the improvements are likely significantly to improve property values within the MID by promoting the development of the property.

The ordinance providing for the establishment of a RID must contain similar findings to those as described above.

If the local governing body approves creation of the improvement district, it can authorise financing by means of assessments. The assessments must be made on all real property located within the district, other than property constituting improvements. As stated above, no assessment can be made by a municipality on owner-occupied residential property without the consent of the owner. As described above, no assessments may be imposed by a county without the consent of a majority of the owners of real property within the district and representing at least 66% of the assessed values of all real property within the district. All owners of property in the RID must consent to the assessments imposed by the RID statute. In all cases, the assessments may be based upon assessed value, front footage, area, per parcel basis, the value of improvements to be constructed within the district, or a combination of them.

Pursuant to the *Livingston* case, the local government has much discretion in determining the methodology of assessment and the quantum of the assessment.

An assessment imposed upon real property remains valid and enforceable even if there is a later subdivision and transfer of the property or a part of it. The improvement plan may provide for a change in the basis of assessment upon the subdivision and transfer of real property. Although it is not a tax, the assessment is imposed, collected, and enforced as a property tax, subordinate only to the property tax.

Credit Considerations

Special assessments on undeveloped land can create burdensome assessment payments for those properties. Undeveloped land typically carries property value-to-debt ratios of 3:1 or less, whilst developed properties are generally closer to 20:1. To have a strong deal, a sensitivity analysis should be done on a multi-year delinquency by the 2 to 5 largest assessment payers. In addition, a sensitivity analysis should also look at a permanent delinquency by all assessment payers with under a 5:1 value-to-overlapping debt ratio. Excess cash, held in a debt service reserve fund or through excess cash flow, should be available to cover a delinquency by at least the 2 to 5 largest assessment payers.

A MID or RID that is largely undeveloped or concentrated in one type of industry is a risky credit. An entirely residential district usually exhibits little concentration of ownership, a very favourable situation, if the district is fully developed or built out.

High property value-to-debt ratios, preferably above 7:1, increase the likelihood that assessment payments will be made on a timely basis. Value to lien ratios should be examined on a parcel by parcel basis for the largest assessment payers.

SSRBs: Special Source Revenue Bonds and Multi-County Business Parks.

Special Source Revenue Bonds ("SSRBs") are secured by and payable from fee-in-lieu of tax payments ("FILOT Payments") made by property owners located in a multi-county business park. Unless the property owner has qualified for and negotiated a reduced FILOT Payment for the capital investment represented by its facility in the park, the FILOT Payment will be in the same amount as ordinary property taxes would have been if the property were not located in the park. Consequently, FILOT Payments are similar to TIF districts in that no additional tax burden is created for the taxpayer; unlike MIDs, RIDs, and special tax districts.

As the result of being in the park, the expenditure of FILOT Payments is subject to the discretion of the county so long as it is applied and distributed as set forth in the park agreement. Consequently, all or any portion of the FILOT Payments can be pledged and applied to pay debt service on the SSRBs.

Under South Carolina law, SSRBs can be issued by counties, municipalities, and special purpose districts that receive and retain FILOT Payments. However, only county governments are authorised under South Carolina law to take the steps necessary to provide for FILOT Payments, which are the source of debt service payments on SSRBs. SSRBs are payable solely from all or that portion of the issuer's FILOT Payments that are pledged as security for the SSRBs. The FILOT Payments which are pledged as security for the SSRBs are not necessarily FILOT Payments that are derived from the project which is benefitted by the SSRBs. FILOT Payments derived from unrelated projects, or entire pools of FILOT Payments derived from other (including all other) FILOT Payments received by the issuer may be pledged to secure the repayment of the SSRBs. In addition, SSRBs issued to finance the acquisition of real or personal property may be additionally secured by a mortgage of that real or personal property. (See S.C. Code Section 4-29-68(A)(2).) If located within the same geographical area, financing for a project can be supported by both FILOT Payments and TIF revenues. (See *S.C. Code Section 4-29-68(F).)*

SSRBs are issued under the provisions of the South Carolina Industrial Development Bond Act (S.C. Code Sections 4-29-10 et seq.) Consequently, the following findings must be made by the local governing body prior to the issuance of SSRBs:

- the project to be financed will subserve the purposes of the Act.
- the project is anticipated to benefit the general public welfare of the locality by providing services, employment, recreation, or other public benefits not otherwise provided locally.
- the project will give rise to no pecuniary liability of the local government or a charge against its general credit or taxing power.
- the amount of bonds required to finance the project.
- the amount necessary to pay annual debt service on the bonds.
- the amount necessary to be paid into reserve funds for the bonds.

If the SSRBs are to be paid from a negotiated FILOT Payment, then the county council must also make the following findings regarding the approval of the negotiated FILOT Paymentsin addition to those described above:

- the purposes to be accomplished by the project are proper governmental and public purposes.
- the benefits of the project are greater than the costs.

The uses of SSRBs are generally broader than for TIFS or MIDs. S.C. Code Section 4-29-68(A)(2) provides that SSRBs must be issued to fund (i) infrastructure serving the issuer of the bonds or the project or (ii) improved or unimproved real estate used in the operation of a manufacturing or commercial enterprise. In either case, the local government that issues the SSRBs must determine that the property financed with the SSRBs enhances the economic development of the issuer. The statute provides that the proceeds of the SSRBs may be used (i) directly for infrastructure owned or controlled by the issuer or (ii) to make loans or grants to, or to participate in joint undertakings with, other agencies or political subdivisions of the State that own or control the infrastructure.

It is significant that, unlike TIFs and MIDs, property financed with SSRBs need not necessarily be owned by a governmental entity. If infrastructure is being financed, it must "serve" the issuer or the "project." It can be either "owned or controlled" by the issuer or some other agency or political subdivision. Control of the infrastructure can be achieved by a variety of means, including the planning and zoning process of the issuer of the SSRBs.

Unlike TIF districts, multi-county business parks can be created without the need to obtain property owner consent. On the other hand, no hardship is inflicted upon the property owner merely by including his property in the multicounty park. That is

because inclusion in the park does not increase the amount of taxes or fees payable by the property owner; it merely changes the legal characterisation of the tax to a FILOT Payment. Although municipalities and special purpose districts are authorised to issue SSRBs, multicounty parks may only be created by county council. If the property to be included in the park is located within the corporate limits of a municipality, S.C. Code Section 4-1-170(C) requires the consent of that municipality in order to include the property within the park. The creation of a multicounty business park also requires, as its name implies, the cooperation of a contiguous county in order to form the park. (See, S.C. Code Section 4-1-172.) In addition, the contiguous county is entitled to receive a negotiated portion of all fee-in-lieu of tax payments made with respect to property located in the park.

Credit Considerations

The issuance and sale of SSRBs can be more problematic than the sale of TIF or MID bonds. The bond market is familiar with financings based upon TIF revenues or MID assessments. Bonds payable from FILOT Payments are far less common in the market. Consequently, there is a steeper learning curve for potential investors in SSRBs. Where SSRBs are secured by a pledge of FILOT Payments to be made by a single industry or other property owner, the rating agencies and many investors look at the bonds more like "corporate bonds" of that industry and less like "municipal bonds" of the issuer. That shift in focus can result in more difficult and different standards to be met for the issue than would otherwise apply to a "municipal bond."

The IRS has recently promulgated regulations regarding the tax analysis of bonds payable from FILOT Payments.

Special Tax Districts.

County governments in South Carolina are authorised to create "special tax districts" for the purpose of assessing property and imposing property taxes and uniform services charges, including taxing different areas at different rates related to the nature and level of governmental services provided for functions and operations of the county government, including, but not limited to, general public works, including roads, drainage, street lighting, and other public works; water treatment and distribution; sewage collection and treatment; public health; social services; transportation; planning; economic development; recreation; public safety, including police and fire protection, disaster preparedness, regulatory code enforcement; hospital and medical care; and sanitation, including solid waste collection and disposal.

There are three methods by which special tax districts can be created by county council;

- by petition of at least 75% of the resident freeholders who own at least 75% of the assessed valuation of property to be included in the district.
- by designating the entire unincorporated area of the county as a special tax district.
- by petition of at least 15% of the voters residing within the proposed special tax district, followed by a referendum within the proposed district approved by a majority of the voters voting in the referendum.

When the district is created either of the two petition methods described above, the petition must set forth the maximum amount of the special tax or user fees to be imposed on property located in the special tax district. If that maximum amount provides an adequate cushion in the event of property tax delinquencies by some of the property owners in the district, the deal can be structured along the lines of a California Mello-Roos deal, which generally receives higher ratings than a typical TIF or Special Assessment bond financing.

Unlike a TIF district, the special tax district does create an additional tax or user fee burden on the property owners within the district. Like a MIDs district, u8ndeveloped land within a special tax district can result in high debt burdens which cause concerns for rating agencies and investors in bonds backed by the special tax district. And where tax levies or user fees imposed within a special tax district are based on something other than ad valorem value of the real property, revenues from the special taxes or user fees do not increase as property values rise. On the other hand, if the special tax is measured just like a normal property tax, the district and its financing will benefit from the growth in the tax base resulting from new development.

Credit Considerations

According to the bond rating agencies, the greatest risks associated with a special tax district financing occur in the district's initial phases, when the taxpayer base is concentrated and debt-to-assessed value (loan-to-value) ratios are high because land may be owned by a few developers and largely undeveloped. As development occurs, credit quality should improve to the extent that ownership becomes more diverse, and loan-to-value ratios decrease. Even a special tax district consisting of relatively undeveloped land can receive a favourable initial rating if the area is characterised by many taxpayers, good loan-to-value ratios, and a sufficient cushion under the maximum allowed tax or user fee rates to cover taxpayer defaults.

An investment grade special tax district will show at least close to 1x cash flow coverage of debt service from parcels in the special tax district that have an assessed value to debt ratio of at least 5:1, with no major taxpayer concentration among these higher value to lien taxpayers.

Special tax districts have received little attention from developers in South Carolina, but they have several attractive features that lend themselves to economic development financing. General purpose projects, such a fire or police substations that are required by local government as a condition for land development permits, are more generally financed by, and accepted by residents of a new development as payable from, property taxes. On the other hand, specialised services that are provided only to a few commercial or industrial properties within the development can be assessed as a user fee associated with that service only to those properties without assessing them against all property in the district. And finally, the statutory procedures under the 75% petition process are simpler than any of the other incentive districts.

From a credit perspective, the strongest special tax districts have economic diversity, with many taxpayers and high value-to-loan ratios, and a special tax levy or user fee that is designed to cover a broad tax base. If that existing tax base can produce favourable coverage of future maximum annual debt service ("MADS"), with an additional bonds test that locks in that coverage, the district's bonds can expect a strong bond rating.

Additional bonds tests can take a variety of forms. The strongest is the test that uses the maximum permitted tax rate on the existing tax base to calculate a minimum coverage requirement on future MADS. Tests based solely on revenues from owner-occupied residences as determined by certificates of occupancy or the county assessor are stronger than tests based on the number of building permits that have been issued because of the time lag between receiving a building permit and completing construction. Weaker tests that are seen include those that require only an appraiser's report estimating minimum value-to-lien ratios. In the current bond market, the weaker tests are unlikely to be financeable.

As with other economic development incentives, the concentration of special tax district taxpayers is a particular risk for small or start-up districts, with its concomitant risks of default or bankruptcy of a major taxpayer. The ability to raise tax rates may mitigate concentration risks if additional tax levies could cover delinquencies by major taxpayers. If the maximum tax rates are designed to increase periodically to match increasing debt service or inflation, the inflation assumptions should be carefully scrutinised to ensure that homeowners will not be subject to onerous levels of taxation in later years.

For utility projects, counties in South Carolina have traditional issued so-called "double barreled" bonds to provide project financing for special tax districts. These bonds are general obligations of the county, secured a pledge of the county's full faith, credit, and taxing power, and are additionally secured by a pledge of the special tax or user fees imposed on property within the special tax district. South Carolina law requires that the amount of the special tax or fees to be collected will be sufficient to pay debt service in full without resorting to the county's general taxing powers. By virtue of the county's general obligation pledge, the bonds will enjoy the county's (expected) higher bond rating than would otherwise obtain based solely on the credit strength of the special tax district. If the bond-financed project consists of facilities for sewage disposal or treatment, fire protection, street lighting, garbage collection and disposal, water service, or any other service or facility benefitting only the special tax district, the bonds will not count against the county's 8% constitutional debt limit by application of Article X, Section 12 of the South Carolina Constitution.

As an alternative to the issuance of general obligation bonds, revenue or special assessment bonds can be issued to fund projects for a special tax district, payable solely from the special tax or user fee imposed within the district.

Major credit considerations involved in the issuance of special tax district bonds include:

- surrounding economic characteristics.
- the nature of the development and the developer's track record.
- tax-to-property value relationships, with emphasis on the percentage of the tax generated by parcels with value to lien ratios above 5:1.
- restrictions on additional parity debt.
- existence of overlapping special tax districts or other types of districts (e.g., MIDs districts).
- project feasibility.
- nature and diversity of the items taxed or responsible for the fee payments and the tax or fee structure.
- cash flow timing and sensitivity to taxpayer or ratepayer defaults.
- county assessment and collections practice.
- the property value added by the funded project.

The ability to raise tax rates, while limited by the amount or mechanism set forth in the initiating petition, provides special tax districts with potentially better credit quality characteristics than most MIDs or TIF districts.