MEMORANDUM

TO: Carrboro Board of Aldermen
Chapel Hill Town Council
Hillsborough Board of Aldermen
Orange County Board of Commissioners

FROM: Intergovernmental Work Group on Alternative Revenues

RE: Impact Tax

DATE: February 01, 1989

As a result of tremendous growth, the localities of Orange County, including the local school districts, are confronted with over $200,000,000 in capital needs- needs which are straining the property tax and other primary sources of general fund revenue. During the past year, the Intergovernmental Work Group has considered several alternative revenue sources to help finance the capital facilities and improvements needed to meet the demands of new growth. Initially, our discussion centered on the implementation of impact fees which are already authorized by local enabling legislation. Later, the Work Group discussed the merits of a land transfer tax. Finally, over the past several months, the group has focused on the impact tax.

Recognizing the time constraints and other factors involved in gaining special enabling legislation, the group decided that we should recommend pursuing only one alternative revenue source. As a result, the group is recommending the impact tax, a concept that we have concluded is a preferable alternative to the impact fee, which is now widely authorized in North Carolina.

Most of our discussion on the implementation of an impact tax concerned the following key questions and issues.

1. Why should we support an impact tax?

A number of new revenue sources are talked about across the State, including local payroll taxes, personal income taxes, and a sales tax extended to services. Our criteria in choosing among these various options included several key interrelated objectives: (1) relieving our localities' increasing dependence upon the ad valorem tax; (2) achieving a more equitable distribution of the financial burden associated with capital improvements necessitated by new growth; (3) establishing a revenue source which would be relatively easy and economical to administer; and (4) insuring that we would have flexibility in the use of revenue derived from the new source.

In reviewing the feasibility of implementing impact fees, our group identified a number of significant obstacles. For example, before proceeding with fees, we must develop a comprehensive long range capital improvement plan and schedule. Unlike property taxes, impact fees are an exercise of local power to regulate land development and do not represent a source of general revenue. Instead, the funds collected from these fees must be determined and used in accordance with a strict need/benefit standard. This standard or rational nexus criteria developed by the Courts results in a number of administrative requirements involving the earmarking of revenue for specific projects, elaborate accounting of fees collected and expenditure of revenue within strict time frames.

In responding to problems with the impact fee, the use of an impact tax was suggested. At the group's request, a report contrasting the impact fee and impact tax was prepared which highlighted key advantages of the latter approach. In contrast to the fee, the impact tax represents an exercise of local taxing power. This distinction eliminates the nexus requirements, which make impact fee systems so administratively cumbersome. Like the fee, the impact tax is assessed according to the relative impact of each development, so the relationship between those who create the need and those who pay is still there.

Essentially, by providing additional funds for capital improvements and by relieving pressure on the ad valorem tax, impact taxes achieve all four of the objectives underlying our criteria, while impact fees fail to achieve the two latter objectives relating to administrative feasibility.

Aside from the advantages outlined above, the strong atmosphere of interlocal cooperation existing in Orange County is a primary factor in our decision to recommend the impact tax. Much of our projected growth in the County lies within the municipalities' extraterritorial areas and within the joint planning transition areas outside Carrboro and Chapel Hill. The municipalities within Orange County do not have, acting in and of themselves, the constitutional authority to levy impact taxes in these areas outside of their corporate limits. Under the system recommended by this group, however, the County would use its taxing authority to levy and administer the impact tax countywide.

2. *Who pays the impact tax and when?*

Our proposed legislation defines the impact tax as an excise tax on land development in Orange County. Under this bill, any individual or party responsible for the construction of dwelling units or commercial buildings pays the tax. These individuals are further defined in Section 2 as those persons who own new constructions at the time an occupancy permit is issued.

The tax would be due on or before the date an occupancy permit is issued.

3. ***How would the impact tax be assessed? per dwelling unit or by square footage?***

Initially, the Work Group considered a per unit tax for residential development and a tax based on square footage for commercial development. After a good bit of discussion, the group decided that a square footage basis would be a more equitable approach for assessing residental as well as commercial development.

4. ***How would the tax rate be determined?***

Our first step is to obtain the necessary enabling legislation authorizing the impact tax. Following such legislation, the County would adopt a local ordinance establishing the tax and the rate. Based upon staff projections, impact tax revenues would meet only a portion of the expense associated with capital improvements necessitated by new growth.

The impact tax rate would be set to reflect the relative impact of various forms of new construction on the need for, and provision of, new community facilities and infrastructure. The work group's recommendation is that this rate should reflect a concern for preserving affordable housing. In establishing or changing the tax rate, local elected officials would be governed by the political accountability present with other decisions affecting local taxes, fees and charges.

5. *How much revenue would be generated from the impact tax?*

The first step in estimating the amount of revenues to be generated by an impact tax is to estimate the building activity by unit type and by square footage constructed. The following table provides estimates based on the average number of units built in each jurisdiction from 1980 to 1988.

CURRENT ESTIMATE OF HOUSING ACTIVITY BY UNIT TYPE

PLACE	SINGLE FAMILY UNITS	SINGLE FAMILY SQ. FT.	MULTI-FAMILY UNITS	MULTI-FAMILY SQ. FT.	MOBILE HOMES UNITS	MOBILE HOMES SQ. FT.	TOTAL UNITS	TOTAL SQ. FT.
Carrboro	59	118,000	267	261,660	3	3,000	329	382,660
Chapel Hill	128	256,000	355	347,900	3	3,000	486	606,900
Hillsborough	10	20,000	30	29,400	41	41,000	81	90,400
Orange County	303	606,000	30	29,400	397	397,000	730	1,032,400
Total	500	1,000,000	682	668,360	444	444,000	1,626	2,112,360

Average single family unit used = 2,000 square feet
Average multi-family unit used = 980 square feet
Average mobile home unit used = 1,000 square feet

Source: Averages were derived from the Orange County Planning Department's report on "Estimation of Fees Generated On A Square Footage Basis As Applied To Residential Construction", 11/15/88.

Estimated revenues which could theoretically be generated by using a $.50 tax per square foot for housing results in the following:

RESIDENTIAL ESTIMATED REVENUES
USING A $.50 PER SQUARE FOOT TAX

PLACE	TOTAL SQUARE FOOTAGE	TOTAL REVENUES
CARRBORO	382,660	$ 191,330
CHAPEL HILL	606,900	303,450
HILLSBOROUGH	90,400	45,200
ORANGE COUNTY	1,032,400	516,200
TOTAL	**2,112,360**	**$1,056,180**

Tax revenues generated by a theoretical $1.00 per square foot of commercial space resulted in the following:

PLACE	COMMERCIAL CONSTRUCTION FEE @ $1.00/SQ. FT.
CARRBORO	$ 66,000
CHAPEL HILL	185,000
HILLSBOROUGH	22,000
ORANGE COUNTY	33,000
TOTAL	$284,000

*Commercial square footage based on the past three-year average in Chapel Hill, past five-year average in Carrboro, and over the last fiscal year in Orange County. Hillsborough's commercial square footage was estimated by multiplying an average of eleven (11) commercial structures per year by a 2,000 square foot per structure estimate.

Combining both Commercial and Residential Revenues result in the following table:

TOTAL REVENUES

Carrboro	$ 257,330
Chapel Hill	488,450
Hillsborough	67,200
Orange County	661,600
T O T A L:	**$1,474,580**

6. *What formula would be employed for the allocation of impact tax revenue among the various localities of the County.*

Our work group recommends a formula which would return 75 percent of revenue collected within the Towns' planning and extraterritorial areas to their respective jurisdictions, retaining 25 percent for the County to be used primarily for schools. 100 percent of revenues generated in Orange County outside the four Towns' planning areas would be retained by the County to be used for capital improvement projects including schools.

Projections based on this formula are as follows:

25% - RESERVE

	TOTAL	RESERVE	NET UN-RESERVED
CARRBORO	257,330	64,332	192,998
CHAPEL HILL	488,450	122,112	366,338
HILLSBOROUGH	67,200	16,800	50,400
ORANGE COUNTY	661,600	165,400	496,200
T O T A L	$1,474,580	$368,644	$1,105,936