

**Senate Committee on Transportation & Homeland Security
House Committee on Transportation
Joint Public Hearing**

**Agenda Item 7: Transportation Reinvestment Zones
Testimony of Brian Cassidy**

House Appropriations Committee Hearing Room; E1.030
Austin, Texas
February 1, 2010

Good morning. My name is Brian Cassidy, and I am a partner in the law firm of Locke Lord Bissell & Liddell LLP. I was involved with the initial legislation authorizing the creation of transportation reinvestment zones (“TRZ”), and I have worked on subsequent proposed TRZ-related legislation and on the actual formation of TRZs pursuant to the TRZ statutes.

I appreciate the opportunity to appear before the Joint Committee. My testimony will attempt to provide an overview of the history, purpose, and practical application of TRZs as a tool to aid in the funding of transportation projects, as well as to identify certain improvements to the TRZ legislation that may warrant consideration by the Legislature.

I. Overview of TRZs

TRZs are an innovative tool for generating transportation project funding by capturing and leveraging the economic growth that results from a project. Development of new roads, and the expansion or improvement of existing roads, often spurs increased economic development in areas around a project. This can be in the form of construction of new homes and businesses in previously undeveloped areas or through the redevelopment of existing areas which, as a result of a project, experience improved access to homes and businesses. As development or redevelopment occurs, property values in those areas increase. A TRZ allows a city or county to designate an area around a project and to capture the increase in ad valorem tax revenues resulting from the increase in property values for use in connection with the financing of the project. In this manner the economic growth attributable to the project is used to support the funding of the project.

It is important to note that a TRZ does not result in a tax increase- it is merely a specific dedication of the incremental tax revenues generated within the boundaries of a TRZ. A TRZ operates in a similar manner to a tax increment reinvestment zone (“TIRZ”) and the related tax increment financing that is often used by local governments to support economic development within an area. However a TRZ is focused specifically on transportation project funding, and the process for forming and administering a TRZ is much simpler than for a TIRZ.

There is one significant limiting factor concerning the use of TRZs, and that is that under current law TRZs may only be established for a project which is anticipated to be the subject of a

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pass-through toll agreement with TxDOT. Elimination of this limitation, as was proposed in the previous legislative session, would expand the use of TRZs in connection with transportation project funding.

II. Original TRZ Legislation (SB 1266)

Senate Bill 1266 was enacted by the 80th Texas Legislature. The bill was co-sponsored by Sens. Brimer and Shapleigh in the Senate and by Rep. Krusee in the House, although the bill was amended in its entirety on the House floor by Rep. Pickett. SB 1266 amended Chapter 222 of the Transportation Code, and the TRZ provisions appear in §§222.105-107.

A. History. As initially conceived TRZs were intended to be a mechanism to help replenish the availability of pass-through funds. The pass-through program (authorized in the 78th Legislative Session-HB 3588) had proven to be popular with local governments, and the filed legislation called for a “Transportation Reinvestment Fund” to be established in the state treasury into which a portion of the proceeds from TRZs were to be deposited and made available for additional pass-through projects. As the legislation evolved the concept of replenishing the pass-through funds was eliminated, and TRZs became a means to generate funding for a transportation project with the funds remaining under local control. The linkage to the pass-through program remained.

B. Structure. The purposes for which a TRZ may be formed are to (i) promote public safety; (ii) facilitate development and redevelopment of property; (iii) facilitate the movement of traffic; and (iv) enhance a local entity’s ability to sponsor a pass-through project. (Transp. Code, §222.105). A TRZ may be formed by either a municipality or a county, but while the formation process is similar for both, the collection mechanism is not.

1. Formation Process. The following general steps must be taken to form a TRZ:

a. The governing body of a municipality or county must determine that an area is unproductive or underdeveloped, and that formation of a TRZ would further the purposes described above (i.e., promote safety, facilitate movement of traffic, etc.). (Transp. Code, §§222.106(c), 107(c)).

b. The governing body may propose, by ordinance or resolution, to designate a contiguous area within its jurisdiction as a TRZ to promote a transportation project authorized under the pass-through statutes and which cultivates development or redevelopment of the area. (Transp. Code, §§222.106(c), 107(c)).

c. The governing body must hold a public hearing on formation of the TRZ no less than 30 days before acting to adopt the ordinance or resolution, and must provide newspaper advertisement of the public hearing at least 7 days before the hearing. (Transp. Code, §§222.106(e), 107(e)).

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d. The ordinance or resolution establishing a TRZ must: (i) describe the boundaries of the zone “with sufficient definiteness to identify with ordinary and reasonable certainty the territory included in the zone”; (ii) provide that the zone takes effect immediately upon passage of the ordinance or resolution; (iii) assign a name to the zone; and (iv) contain findings that the project will cultivate development or redevelopment within the zone. (Transp. Code, §§222.106(g), 107(f)). Additionally, the ordinance creating a municipal TRZ must establish an ad valorem tax increment account for the zone. (Transp. Code, §222.106(g)).

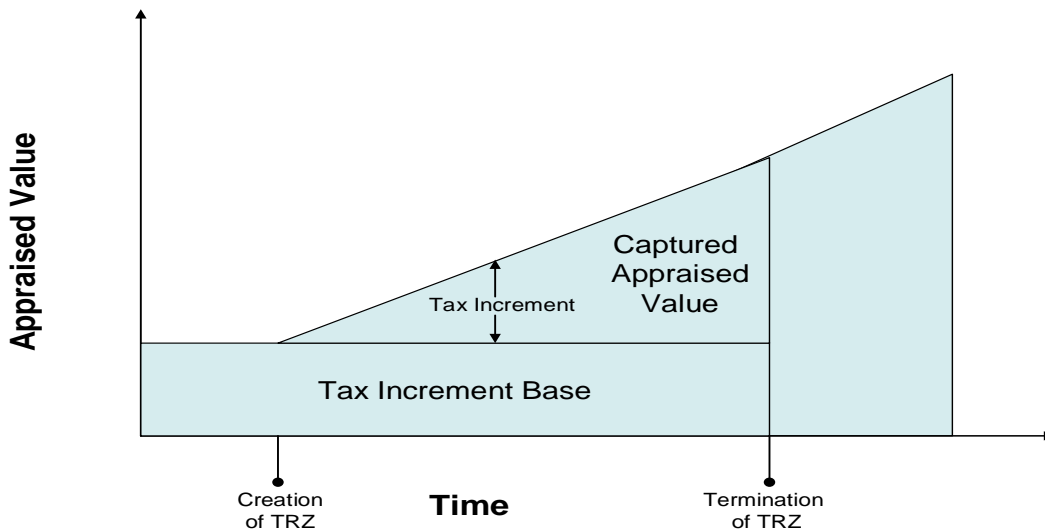
2. Determining the Tax Increment. The tax increment generated by a TRZ is determined as follows (Transp. Code, §§222.106(a), 107(a)):

a. The tax increment for a zone is the amount of ad valorem taxes levied and collected on the “captured appraised value” of property within the zone;

b. The “captured appraised value” is the total appraised value of property within the zone for a year minus the “tax increment base”; and

c. The “tax increment base” is the appraised value of all property in the zone in the year in which the zone was established.

d. The application of these concepts, and the aggregation of TRZ revenues, is depicted below:



3. Collection. While the formation process for municipal and county TRZs is virtually identical, there are differences in the manner in which each secures the benefit of the tax increment.

a. **Municipalities:** A municipality establishes a tax increment account and pays an amount equal to the tax increment into the account each year. All of the tax increment amount must be deposited to the tax increment account. (Transp. Code, §222.106(h)).

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Funds in the tax increment account must be used to fund projects authorized under the pass-through statutes. (Transp. Code, §222.106(i)). As a result, municipalities do not appear to have discretion to utilize a portion of the tax increment for other purposes; it must all be used for pass-through projects.

b. **Counties:** In order to obtain the benefit of the tax increment, a county may abate taxes in an amount up to the amount of the tax increment; form a road utility district ("RUD") with the same boundaries as the TRZ; and allow the RUD to impose taxes in the district in an amount equal to taxes abated. (Transp. Code, §222.107(h)-(k)). This collection mechanism is necessary due to an apparent constitutional limitation on the authority of a county to implement tax increment financing. Art. VIII, Sec. 1-g(b) of the Texas Constitution authorizes "an incorporated city or town" to issue bonds for development or redevelopment of property and to pledge increases in ad valorem tax revenues for the repayment of those bonds or notes. Art. VIII, Sec. 1-g(b) does not expressly grant that same authority to counties. Therefore, as noted by the Office of the Attorney General in its "2008 Economic Development Handbook" (at p. 117, fn 551): "...county-initiated tax increment financing may potentially be subject to constitutional challenge until such time as the constitution is amended." Legislative Council raised the same concern during the drafting of SB 1266. In the event a RUD is used to collect the tax increment, funds not used for financing of the project may be used "for any district purpose." (Transp. Code, §222.107(k)). The scope of permissible uses of TRZ generated funds is therefore broader under the county/RUD structure, as municipalities are restricted to using TRZ funds for pass-through-type projects.

III. Proposed Legislation (HB 1810/SB 2378)

As a result of practical experience with the TRZ legislation and a recognition of the value of its use as a tool to generate local funding for important projects, several improvements to the TRZ statutes were proposed during the 81st Legislative Session. These were embodied in companion bills field by Rep. Pickett (HB 1810) and Sen. Nichols (SB 2378). Those bills would have made the following changes:

A. De-couple TRZs from the Pass-Through Program. "De-coupling" TRZs from the pass-through program would have allowed TRZs to be created to support a broad range of transportation projects. Under current law TRZs may only be established by municipalities and counties intending to enter into pass-through toll agreements with TxDOT. (Transp. Code, §§222.106(b), 107(b)). Pass-through toll agreements may only be used for tolled or nontolled facilities on the state highway system. (Transp. Code, §222.104). The engrossed versions of HB 1810 and SB 2378 both provided for the use of TRZs for transportation projects as defined by §370.003, Transp. Code, which would therefore have included passenger and freight rail projects, pedestrian or bicycle facilities, intermodal hubs, certain types of airports, and various other transportation projects (in addition to tolled and nontolled roadways) among the types of facilities which TRZs could support.

B. Increase Flexibility for Municipal Use of Tax Increment Amounts. This change would have allowed a municipality to designate "all or a portion" of the tax increment

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amount generated in a TRZ to be used for a project. Current law appears to require that all of the tax increment in a municipal TRZ be used for pass-through projects, which can be a disincentive to the use of a TRZ as it may be perceived placing too much restraint on the use of future revenues. The proposed legislation would have allowed a municipality to determine how much of the tax increment was to be used for the transportation project for which the TRZ was created, and to determine the purposes for which the remaining increment was to be used.

C. Improve County Collection Mechanism. Under current law the RUD mechanism for counties (resulting from a constitutional issue- see discussion at II.B.3.b above) is complicated and confusing to the public. This change would have provided an alternative mechanism for collection and use of TRZ proceeds by counties. The modified structure, similar to how assessments are levied and collected in a Public Improvement District, would be easier to implement.

D. Permit Amendments to TRZ Boundaries. This proposed change would have allowed for amendments to TRZ boundaries to accommodate changes to the scope of a project. A TRZ may be formed before the exact limits of a project are defined (or those limits may change due to subsequent events), and without express authority to amend the boundaries of a TRZ it may not be legally permissible to do so.

E. Recognize Pre-Existing Tax Increment Commitments. For purposes of determining the amount of the tax increment within a TRZ, this change would have made clear that the increment amount should not include amounts attributable to TIRZs or other economic development agreements that were established within the boundaries of a TRZ before the TRZ was formed. In other words, pre-existing TIRZs and prior commitments made through economic development agreements should be recognized and excluded from the tax increment generated by a TRZ.

F. Prohibit Reductions in Funding. This change would have provided an express prohibition against the reduction in traditional funding to a municipality, county, or TxDOT district because a TRZ is formed within those areas, and would have specifically precluded the reduction in funding previously identified by TxDOT for a project because a local government decides to create a TRZ for the project. This was intended to allay concerns that if a local government created a TRZ to enhance local funding for a project that it would lose the benefit of previously committed funds from the state.

G. Delegate Project Development Responsibility. Consistent with what is currently provided for under the pass-through program, this change would have provided for the delegation of responsibility to local entities for various aspects of the development of projects that are otherwise subject to oversight by TxDOT (provided that projects on the state highway system must comply with state design criteria unless TxDOT grants exceptions). This was intended to enhance local control over projects where there was significant local investment, while still providing for coordination with TxDOT.

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H.. Clarify Authorization to Pledge TRZ Revenues. The proposed legislation would have clarified language regarding the pledge of revenues from a TRZ as part of a project financing. While it appears clear from the existing statutory language that pledging of TRZ revenues was both permitted and anticipated, this would have addressed any lingering concerns and provided absolute clarity so as to better facilitate financing transactions.

IV. Sales Tax TRZs

A related concept which has been discussed, and which is the subject of one of the Senate's Interim Charges (Transportation & Homeland Security, Charge No. 5), is the possibility of authorizing TRZs to be created for the purpose of collecting state sales and use taxes for use in the funding of a transportation project.

During the 81st Legislative Session (as well as in the previous session) Sen. Ogden proposed a similar concept in SB 505, which would have authorized the creation of "Transportation Finance Zones." Under that concept, as reflected in the House Committee Report, the Transportation Commission would be authorized to create a zone generally of up to 2 miles on either side of a project, subject to approval by the Legislative Budget Board of the zone and its boundaries. State sales tax proceeds from transactions consummated within the zone would be collected and remitted to TxDOT (to be deposited in a revolving fund) for the specific purpose of repaying financial assistance provided to TxDOT for tolled or nontolled projects within the zone. There was a specific prohibition against using the funds to provide financial assistance for a project developed and operated by the private sector or through a comprehensive development agreement.

SB 505 was accompanied by SJR 18, which proposed an amendment to the state constitution to allow for this type of dedication of sales tax proceeds and the deposit of the proceeds into the Texas Mobility Fund. (SB 505, in the House Committee Report, had the proceeds going to a revolving fund- a change not reflected in SJR 18). The legislation limited the amount which could be collected and deposited to the fund to \$250 million per fiscal year, and an LBB fiscal note accompanying the legislation noted that it would have the effect of reducing general revenue by up to \$250 million, but that the reduction would be offset by an increase in TxDOT's available funding by the same amount.

While not addressed in SB 505, there are other concepts which may be considered concerning the use of sales tax revenues in relation to a TRZ-type structure. These include:

- * Limiting the state sales and use tax capture to the amount of increased sales and use tax over the aggregate of the base year collections in the zone (i.e., capture the incremental increase). This would limit the impact on the state's general revenues.

- * Allowing a TRZ to combine the ad valorem tax increment with the state sales and use tax increment. Note that this would require state action in the creation of the TRZ, as local governments cannot unilaterally designate the use of the state portion of sales and use taxes.

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* Allowing local governments to capture all or a portion of their incremental local sales and use tax generated within a TRZ (similar to what is permitted for TIRZs under §311.0123, Tax Code).

* Allowing local governments to combine the collection of the ad valorem tax increment authorized under the current TRZ structure with the local sales and use tax increment within a TRZ.

V. Recommendations

TRZs represent a valuable tool for helping local governments fund transportation projects. However their utility is limited by the connection to the pass-through toll program administered by TxDOT, as well as by other restraints in the current legislation. Pursuing the changes that were previously proposed in HB 1810 and SB 2378 and are described in Section III above would greatly enhance the value of TRZs. In addition, consideration should be given to advancing a constitutional amendment that would grant counties the same ability as municipalities to pledge incremental tax revenues to the payment of bonds and notes for development and redevelopment projects (see Section II.B.3.b above). Finally, options for capturing state and local sales and use taxes within a TRZ should be further explored.