Revenue Sharing: An Important Economic Development Tool For Virginia Localities

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Historically, Virginia's unique and fractured system of local government—with its independent cities and counties—has made regional economic development efforts among Virginia localities extremely rare. In more recent years, however, local government leaders have come to realize that they must find ways to work with neighboring jurisdictions to pool available resources if they are to succeed at bringing new businesses and jobs to their communities. As a result, revenue sharing agreements have emerged as an important tool available to local governments in their efforts to establish successful regional economic development projects.

The Urban Partnership and the Virginia Chamber of Commerce have strongly endorsed revenue sharing as a means of promoting cooperation among localities that will make regions within Virginia more competitive in the economic development field. The chamber of commerce has noted that regions that work together are stronger and more successful. Often, a single jurisdiction working alone is not able to attract a business or industry. Furthermore, in many regions of Virginia, counties have the land, while cities have the capital. The chamber of commerce has also reported that without revenue sharing, the benefits of attracting a business prospect to an area may be distributed very unevenly. One locality may reap most of the tax revenue rewards because it has much more land suitable for development, while another locality may absorb most of the added costs for transportation and education services.

Background

The statutory authority for revenue sharing agreements among Virginia localities was originally enacted as part of the 1979 compromise that resulted in a major revision of the annexation and governmental status provisions of the Virginia Code. Former Virginia Code §§ 15.1-1166 and 15.1-1667 authorized counties, cities and towns to enter into agreements to share in the "benefits of the economic growth of their jurisdictions." Such an agreement was permitted if a city relinquished its annexation authority for all or any part of an adjacent county or for "any other purpose," including the regional provision of one or more "public services or facilities."[1]

After the moratorium on city annexations was lifted in 1979, revenue sharing was used almost exclusively in a defensive manner as an alternative to annexation. For example, some of the initial agreements using this authority—Charlottesville/Albemarle County, Franklin/Isle of Wight County, and Lexington/Rockbridge County—involved a permanent waiver of annexation rights in exchange for a "tax base" sharing.

With the reenactment of a city annexation moratorium in 1987 and the increased interest in economic development among all Virginia localities, the focus of revenue sharing arrangements has shifted in recent years to joint efforts to pool resources to compete for commercial and industrial businesses and to share in the revenues generated by such new development.

Statutory Authority For Revenue Sharing

Two general law provisions grant broad revenue sharing authority to all Virginia localities.[2] In addition, several other provisions grant more narrow revenue sharing powers that are applicable to a limited number of jurisdictions.[3]

Voluntary Settlement Agreements

The first broad grant of authority to share revenues established by the General Assembly, and the one most often utilized by localities, is found in Virginia Code §§ 15.2-3400 through 15.2-3401. Under these two statutes, any two or more localities may enter into an agreement to settle matters involving any annexation or governmental status proceeding provided for in Subtitle III of Title 15.2. As originally enacted in 1983, § 15.2-3400 authorizes: waiver or modification of annexation, transition, immunity or other rights provided in Subtitle III; fiscal arrangements; revenue and economic growth sharing; dedication of all or any portion of tax revenues to a revenue and economic growth sharing account; boundary line adjustments; acquisition of real property and buildings; and joint exercise or delegation of powers.[4]

In 1990, an amendment to the statute broadened considerably the scope of such agreements by also permitting the parties to include provisions regarding land use, zoning, subdivision, and infrastructure arrangements, as well as "such other provisions as the parties deem in their best interest."[5] In its present form, the statute gives localities virtually unlimited authority regarding the types of provisions they may include in a settlement, subject to any constitutional limitations, and subject to the court's determination that the agreement is in the best interests of the parties.[6]

A previous amendment to the statute also permitted the parties to provide in the agreement for "subsequent court review" by a three-judge court.[7] This language presumably authorizes a mechanism to enforce the terms and conditions of the order approving the agreement, although it might also allow the court to amend or modify the agreement in the future when one of the parties believes certain terms are no longer equitable.

Under this statutory scheme, a proposed voluntary settlement agreement must be presented to the Commission on Local Government for review.[8] The commission determines whether the proposed settlement is in the "best interests of the Commonwealth," but its findings and recommendations are only advisory in nature. In reviewing proposed voluntary agreements, the commission has recommended court approval of such settlements in most cases, although it often suggests that the parties make minor modifications to the overall agreements. After the commission has issued its report, the localities may adopt the original agreement or a modified agreement after required public notification and hearing.[9]

Upon adoption of a voluntary settlement agreement, the localities must petition a three-judge court for an order establishing the rights of the parties as set forth in the agreement. The statute provides that the court shall approve the agreement unless it finds either that the agreement is contrary to the best interests of the Commonwealth—including the state's interest in promoting the orderly growth and continued viability of local governments—or that the agreement is not in the best interests of each of the parties. This standard is distinct from the requirements for individual annexation, immunity, incorporation, or transition actions. The court has the authority to either affirm or deny the agreement in its entirety, but it may not amend or alter the terms or conditions without express approval from each of the parties.[10] The entry of a court order affirming an agreement makes it binding on future local governing bodies.[11]

The revenue sharing agreement between the City of Bedford and the County of Bedford in 1997[12] is a good example of localities pooling their resources to attract new businesses and sharing the resulting revenues. On the one hand, the city had a water and sewer system, but it had little vacant land suitable for a modern industrial/commercial park. On the other hand, the county had no water or sewer facilities in the areas surrounding the city, but had ample vacant land. Under the agreement, the localities agreed to jointly fund utility improvements and other infrastructure for five industrial/commercial parks and share the resulting tax revenues.

Their agreement said that: the city agreed to extend its water and sewer lines to four proposed commercial/industrial parks in the county; the city's obligation to extend its utility lines is limited to the expenses that can be funded by one-half of the revenue sharing payments it receives from county parks; the city and the county agreed to share equally most tax revenues generated by the four county parks and one existing park located within the city; the city agreed to pay a joint industrial development authority 50% of the net revenues from the city's sales of electric power to businesses in the county parks; and, the county's revenue sharing obligations are subject to annual appropriations by the county; however, if the county elects not to make the payments, the city can immediately annex the four county parks.

Revenue sharing arrangements established pursuant to the voluntary settlement statute present certain hurdles that localities must overcome. The most prevalent one involves the constitutional debt limitations imposed on counties. If such an agreement would obligate a county to make payments that constitute debt under Article VII, Section 10(b) of the Virginia Constitution, then Virginia Code § 15.2-3401 requires that such an arrangement be approved by the qualified voters of the county at a special referendum election before the county enters into the agreement. This Code Section was enacted as a result of "widespread recognition that the obligations of counties under voluntary revenue sharing arrangements establish debt subject to constitutional limitations."[13]

Since the enactment of this provision, localities have attempted to structure revenue sharing arrangements to avoid the referendum requirement applicable to counties. Despite their best efforts, the attorney general has opined that most such arrangements were still subject to the constitutional limitations. Two examples illustrate this point.

An agreement made between the City of Franklin and Isle of Wight County required the county to pay a portion of local tax revenues from a limited geographical area, which contained an existing manufacturing plant. It also required the city to provide certain utility services and to waive its annexation rights. Even though the source of the payments by the county was limited to tax revenues from specific parcels of real property, the attorney general concluded that such an arrangement did not fall within the "special fund" exception to the constitutional debt limitation,[14] because the revenues would otherwise have been "available for general county purposes" and did not involve the "type of revenue-producing, self-liquidating county project contemplated under that doctrine."[15] Likewise, the provision of certain utility services and the continuing waiver of the city's right to seek annexation did not fall within the "service contract doctrine" recognized in Virginia, which exempts from the constitutional debt limitations those county financial obligations payable in future installments as a service is rendered. The opinion noted that the amount of tax revenues "significantly exceeded the cost or value of the services provided."[16]

An agreement between the City of Clifton Forge and Alleghany County provided for the sale of city owned property to a private industry and the perpetual equal sharing of designated tax revenues generated by facilities to be constructed on the site. Because the property is located in the county, the agreement obligated the county to transfer one-half of the tax revenues to the city. Again, the attorney general concluded that the "special fund" exception did not apply to a "fund" consisting of tax revenues that the locality was otherwise "obligated to impose and appropriate" for general county purposes. Thus, the county's obligation to transfer those revenues constituted long-term debt subject to the constitutional limitations.[17]

Economic Growth Sharing Agreements

The second statute granting broad revenue sharing powers was enacted by the General Assembly in 1996. Virginia Code § 15.2-1301 authorizes localities to enter into a "revenue, tax base, or economic growth sharing" agreement that is not a part of an annexation or transition settlement.[18] As discussed above, the statutory authority for "voluntary settlements" under Virginia Code § 15.2-3400 requires some connection with an annexation or governmental status matter, which limits its usefulness for localities that want to provide for revenue sharing outside the scope of any annexation or similar issue. Agreements done pursuant to § 15.2-1301, however, can be used for "any purpose otherwise permitted," including the provision of public services or facilities or "any type of economic development project."

This statute permits all forms of revenue sharing. "Revenues" can include non-tax receipts of a locality such as user fees or state appropriations. "Tax base" can include taxes received from all development, existing and future. "Economic growth sharing" permits an arrangement limited to taxes derived from new development.

An agreement reached under Virginia Code § 15.2-1301 enjoys two procedural advantages over those made under the voluntary settlement statute. As with a "voluntary settlement," the Commission on Local Government performs an advisory review; however, the review can be accelerated because the commission is not required to hold a public hearing or to comply with certain notice requirements. More importantly, § 15.2-1301 does not require that such an agreement be reviewed or approved by any court. Localities cannot use this procedure, however, if the revenue sharing proposal contains "any provision addressing any issue" relating to annexation, immunity from annexation, incorporation of a new town, transition of a town to city status, transition of a county to a city, or transition of a city to town status. As with a "voluntary settlement," any growth sharing agreement made pursuant to Virginia Code § 15.2-1301 that would obligate a county to make payments that constitute debt under Article VII, Section 10(b) of the Virginia Constitution must be approved in a county referendum.[19]

Virginia Regional Industrial Facilities Act

One of the narrower grants of revenue sharing authority is found in Chapter 64 of Title 15.2 of the Virginia Code. Commonly known as the "Virginia Regional Industrial Facilities Act," the act authorizes the formation of regional industrial facility authorities. Under the act, any three or more qualifying localities (but at least two cities or counties) may create a regional industrial facility that may develop and operate an industrial park to be occupied by manufacturing, warehousing, distribution, office or other commercial businesses. The purpose of such an authority is to permit the localities in that region to cooperate in developing such a park because the individual localities lack the resources to pursue such economic development projects.[20] The regional authority may issue bonds for the development of an industrial park.[21]

The act, however, is applicable only to Planning District 4 (counties of Floyd, Giles, Montgomery, and Pulaski, and the city of Radford), Planning District 5 (counties of Alleghany, Botetourt, Craig, and Roanoke, and the cities of Clifton Forge, Covington, Roanoke, and Salem), Planning District 11 (counties of Amherst, Appomattox, Bedford, and Campbell, and the cities of Bedford and Lynchburg) and Planning District 12 (counties of Franklin, Henry, Patrick, and Pittsylvania, and the cities of Danville and Martinsville), as well as the counties of Bland, Smyth and Wythe.

The first such authority was created under the act by 15 localities in the qualifying region.[22] The plan is that this new authority will allow these localities to proceed with projects, such as a new large industrial park in Pulaski County, that could attract major new industries that currently bypass this region of the state. Because the industrial park or parks authorized by this Act may not be located in each of the participating localities, the statutes provide for a sharing of the tax benefits of a successful project. Virginia Code § 15.2-1713 authorizes the members to agree to a "revenue and economic growth-sharing arrangement" as to the tax revenues and other "income and revenues" generated by the industrial park. In addition, the member locality in which a facility is located may remit all machinery and tools tax revenue to the regional authority for payment of debt service of the authority.[23]

The General Assembly has provided that the obligations of member localities to make such revenue sharing payments "shall not be construed to be debt within the meaning of Article VII, Section 10" of the Virginia Constitution. Such an agreement must be approved by a majority vote of the governing body of each member locality, but "shall not require any other approval."[24] Similarly, the payment of machinery and tools tax revenues "shall not constitute a pledge of the credit or taxing power of such locality."[25]

Based on existing opinions of the Virginia Attorney General, there appears to be a substantial question as to the validity of such revenue sharing provisions, especially where a county in which an industrial park is located is unconditionally obligated to make long-term payments of tax revenues generated by the park. It is doubtful the General Assembly can avoid the constitutional referendum requirements merely by legislating that debt obligations do not constitute debt under the Constitution.[26] A regional authority might assert, however, that the "special fund" exception to the constitutional debt limitations is applicable to such obligations, notwithstanding prior opinions by the attorney general. Alternatively, the Supreme Court has ruled that certain "contingent" obligations do not constitute debt under Article VII, Section 10[27] and a regional authority might contend that an obligation to share revenues from an industrial park that might never secure an industry or business does not constitute a debt for purposes of the Virginia Constitution.

Indirect Revenue Sharing: Water and Sewer Rates

In addition to the revenue sharing agreements authorized in the context of voluntary settlements, economic growth sharing arrangements, and through the establishment of regional industrial facilities, the General Assembly has made it possible for certain localities to share revenues indirectly. One of the best examples of such arrangements involves the Town of Front Royal and Warren County.

As of 1997, the Town of Front Royal had the only municipal water and sewer service in Warren County. Certain industries and businesses were interested in locating within a portion of the unincorporated area of the county outside the town limits, but needed to have public utility services. The town proposed to extend its facilities outside its boundaries and to charge the businesses using its water/sewer services, in addition to its normal rates, an amount equivalent to the total property taxes and license fees the businesses would be required to pay if they were located within the town. The attorney general acknowledged that the town could charge out-of-town customers additional sums to extend Front Royal's utilities outside its boundaries and to "assume on a continuing basis any additional costs and expenses incurred by the town in providing the service to the county users."[28] However, he concluded that a charge tied to taxes that would have been collected was improper, because there must be a "cost-based relation between the charge imposed and the benefits conferred."[29]

In an effort to address the Front Royal/Warren County situation, the General Assembly amended and reenacted Virginia Code provisions governing the rates and fees charged by localities for public water and sewer services.[30] As a result of these legislative changes, any town within a 11,000 to 14,000 population bracket may now provide such services to industrial and commercial users outside its boundaries and collect "such compensation therefor as may be contracted for between the town and such user."[31]

This special act apparently permits Front Royal to impose charges, with the agreement of the industry or business, that are not cost-based. Thus, the town may indirectly collect sums beyond the actual "costs" that are equivalent to part or all of the taxes that would have been paid if the business had located within its boundaries. This indirect means of "sharing revenues" also has some benefit for the adjoining county because it does not have to share any of the county tax revenues it collects from the business.

The Future

Efforts in recent years to make it even easier for localities to use revenue sharing as part of their joint economic development plans have not been successful. In November 1998, two proposed constitutional amendments placed on the ballot sought to modify Virginia's constitutional debt limitations.

"Constitutional Amendment No. 4," as it became known, provided for an amendment to Article VII, Section 10 of the Virginia Constitution to create an additional exemption from the debt limitations in that Section for contract obligations of localities to share revenues.[32] In other words, it would have exempted counties from the referendum requirement and excluded such debt from the debt ceiling for cities and towns. The stated purpose of the proposal was to avoid the delay and uncertainties resulting from voter referenda which place Virginia localities at a competitive disadvantage in courting new businesses.

"Constitutional Amendment No. 3" provided for an amendment to Article VII, Section 2 of the Virginia Constitution, which would have also eliminated the debt restrictions in Article VII, Section 10, but would have also gone much further.[33] The amendment would have authorized the General Assembly to provide by general or special act for the sharing of the costs of developing a "designated land area" and the tax revenue generated by the development. Such obligations to finance the development and to share the revenues would also not have been considered debt.

This amendment would have also directed that, in any such legislation, the General Assembly shall provide for a special governing body for the development area whose members would be selected by the governing bodies of the participating localities. The legislature can grant the special governing body any power that can be exercised by the participating localities, including the power of taxation. The apparent purpose of that provision was to permit a higher tax rate to be imposed on the industrial/commercial park, which revenues can be used for the expenses of providing the infrastructure to the site.

Both amendments were defeated, however. Although proponents of the amendments argued that they were merely benign amendments to give Virginia localities more flexibility to compete for industry, opponents raised great concerns about unelected bodies having the power to tax and local governments creating a whole new category of debt not subject to voter approval.

Despite these setbacks, revenue sharing agreements among localities in Virginia are likely to increase in the future as other localities see the rewards reaped by those already participating in such arrangements. Also, the General Assembly continues to be receptive to legislation that promotes cooperative action and therefore will likely support extending some of the existing special grants of authority to additional localities. Although greater use of revenue sharing agreements will not guarantee growth and prosperity for all regions of the Commonwealth, they provide an excellent way for localities to commit to economic development projects that make the best use of a region's available resources. ⚖

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Endnotes

1 1979 Va. Acts, ch. 85, *repealed* by 1983 Va. Acts, ch. 523.

2 Va. Code §§ 15.2-3400 to 15.2-3401; Va. Code § 15.2-1301.

3 Va. Code §§ 15.2-6400 to 15.2-6416; Va. Code §§ 15.2-2119, 15.2-2143.

4 See Va. Code §15.1-1167.1.

5 1990 Va. Acts ch. 62.

6 See Va. Code § 15.2-3400.

7 1986 Va. Acts ch. 333.

8 Va. Code § 15.2-3400(3).

9 Va. Code § 15.23400(4).

10 Va. Code § 15.2-3400(5).

11 Va. Code § 15.2-3400(6).

12 The agreement was entered into pursuant to § 15.1-1167.1, the predecessor statute of § 15.2-3400.

13 1990 Op. Atty. Gen. Va. 6.

14 The special fund exception provides that the constitutional debt limitations do not apply when payments are to be made solely from a specific fund derived from the revenues of a project. See Miller v. Watts, 215 Va. 836, 214 S.E.2d 165 (1975).

15 See 1984-85 Va. Op. Atty. Gen. 96.

16 Ibid.

17 1990 Op. Atty. Gen. Va. 6; see also 1988 Op. Atty. Gen. Va. 546 ("tax increment financing" by a county is subject to referendum requirement).

18 1996 Va. Acts ch. 725.

19 Va. Code § 15.2-1301(C).

20 Va. Code §§ 15.2-6401 to 15.2-6402.

21 Va. Code § 15.2-6409.

22 The counties of Bland, Craig, Giles, Montgomery, Pulaski, Roanoke and Wythe, the cities of Roanoke, Radford and Salem, and the towns of Christiansburg, Dublin, Narrows, Pearisburg and Pulaski all joined to work together on joint industrial parks.

23 Va. Code § 15.2-6406.

24 Va. Code § 15.2-6407.

25 Va. Code § 15.2-6406.

26 See generally Concerned Residents of Gloucester County v. Board of Supervisors, 248 Va. 488, 449 S.E.2d 787 (1994) (supreme court declined to express an opinion as to the effect of a Code provision stating that certain waste disposal contracts "shall not be deemed to be a debt . . . within the meaning of any law . . . or debt limitation.").

27 See Id. at 495, 449 S.E.2d at 792.

28 1997 Va. AG LEXIS 99.

29 Id.

30 Va. Code §§ 15.2-2119, 15.2-2143.

31 Id.

32 1998 Va. Acts ch. 587.

33 1998 Va. Acts ch. 887.