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CENTER FOR
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How-To Brief No. 15: HOW TO IDENTIFY BENEFICIARIES AND ESTABLISH BENEFIT AREAS THAT MEET COMMON LEGAL STANDARDS

Value capture is based on the beneficiary-pays principle, so identifying beneficiaries is central to ensuring that implementation is fair and equitable. Identification of beneficiaries and benefit areas is well established for transit projects but can be more challenging for open-system transportation infrastructure such as highways, roads, and transportation corridors for cylists and pedestrians. Demonstrating the value to beneficieries is key to the success of these techniques. This how-to brief outlines how an agency can identify beneficiaries, benefit areas, and benefit (and cost) levels to prepare for pre-implementation review for legal requirements.

Key Takeaways

> **Open-system transportation infrastructure, including highways, roads, sidewalks, and bicycle corridors, distribute benefits in a wider variety of patterns than transit improvements, making identification of beneficiaries and benefit areas challenging.** A transportation study of the proposed infrastructure and a market analysis of the affected geographical areas and locations are essential for overcoming this challenge.

> **In addition to statutory requirements established by a technique's enabling legislation, the legal principles of uniformity, essential nexus, and rough proportionality have important implications for value capture.** It is important for a sponsoring agency to have all proposed value capture implementation reviewed by agency legal counsel and/or outside counsel specializing in land use law to ensure that all legal requirements are met.

> **The sponsoring agency can prepare for pre-implementation legal review (and subsequent legal scrutiny)** by designing value capture that incorporates: (1) careful identification of beneficiaries and (2) analysis of benefits conferred (and costs incurred) as a result of value capture-supported infrastructure.

Introduction

Investments in transportation infrastructure can create economic benefits throughout a community or region, yet these benefits can be distributed unevenly, resulting in windfall gains to nearby private property owners, land developers, and/or businesses. Value capture encompasses a diverse range of techniques designed to recover a fair share of these unevenly distributed private benefits of a public infrastructure investment to fund the infrastructure itself.

Value capture is based on the beneficiary-pays principle, meaning that those who benefit from transportation infrastructure should bear responsibility for its costs and those who impose costs on infrastructure should bear a proportionate share of those costs.[1] Identifying the beneficiaries and the amount of private benefits they receive from a given public infrastructure investment is central to all value capture. Many value capture techniques require the establishment of districts meant to encompass project beneficiaries. Techniques that are applied jurisdiction-wide distinguish beneficiaries in other ways such as transportation utility fees that estimate road use by building type or developer impact fees that establish rates based on infrastructure costs.

How-to Brief No. 2 covers value capture beneficiaries and the boundaries of benefit areas for determining revenue potential. Identifying beneficiaries and benefit areas can result in legal challenges that can be costly and cause significant delay.

This brief provides basic information to help agency staff design value capture implementations to withstand common legal challenges. It is not a substitute for legal advice. Value capture sponsors should always consult with an attorney who specializes in land use law before implementing a new value capture technique or program to ensure conformity with legal standards for uniformity, due process, rational nexus, and proportionality as well as compliance with enabling legislation and any applicable Federal, state, or local regulations.

Identifying Beneficiaries of Transportation Infrastructure Investments

Transportation infrastructure generates economic benefits by making new connections and/or by reducing transportation time and cost. These savings and new connections have value for households and businesses that use the new infrastructure, which is expressed through increased trips to destinations it serves. Depending on whether the facility serves passengers or freight, these trips result in new expenditures at retail stores and restaurants, better workforce access for employers, and more efficient access to inputs and customers for manufacturers, suppliers, and warehousing and distribution businesses.

Best practices for identifying benefit areas for transit projects are well established. Transit systems are “closed,” meaning that users enter and exit at a limited number of easily identifiable locations. Extensive research demonstrates that the benefits of transit tend to be concentrated in close proximity to transit stations, and patterns in how the level of benefits decline with distance from a station are well understood.

Open-system transportation infrastructure, including non-tolled highways, roads, sidewalks, and bicycle corridors distribute benefits in a wider variety of patterns. Instead of concentrating activity in a station area, they tend to direct benefits based on the population and activity centers they connect and local and regional economic and real estate market characteristics. A highway may create benefits at each on/off ramp along the entire corridor or concentrate benefits at selected on/off ramps due to their proximity to retail locations, existing residential areas, or

[1] NCHRP Research Report 873: Guidebook to Funding Transportation Through Land Value Return and Recycling. Washington, DC: The National Academies Press. https://doi.org/10.17226/25110.

employment centers. It may direct activity to endpoints creating substantial value for certain parcels or collect small amounts of activity throughout the corridor.

Though the impacts may vary greatly from one project to another, they are not completely unpredictable. A transportation study can be used to determine the extent and location of new activity resulting from the proposed new or improved facility. Then a market analysis of the new activity can be used to determine how it will interact with regional population and socioeconomic trends, industry composition and growth, land use patterns, local real estate market trends, and specific characteristics of affected properties and businesses to create economic value (see How to Brief No. 2: How to Identify Beneficiaries and Determine Revenue Potential). Together, the transportation and market studies allow a value capture sponsor to quantify the benefits of the infrastructure and identify where beneficiaries are located.

Some value capture techniques are applied to an entire jurisdiction such as a city or county, while others require establishment of a district intended to represent the area(s) where benefits accrue. The transportation and market studies can be used together to identify whether a jurisdiction-wide or district-based technique is best suited for capturing value. In either case, the studies will also allow the value capture technique or program to be designed to withstand common sources of legal challenges.

Legal Considerations for Value Capture

The FHWA publication "Essential Nexus, Rough Proportionality, and But-For Tests: State of the Practice" addresses the legal issues and standards associated with value capture. This brief will focus on the aspects of these legal issues that are related to identifying beneficiaries and benefit areas.

Uniformity

Article 1, Section 8, Clause 1 of the U.S. Constitution grants the Federal government the power to levy taxes but also states, "all Duties, Imposts and Excises shall be uniform throughout the United States." In practice, to the extent that taxation and fee collection is delegated to state and local government entities, taxes or fees that apply to one person will also apply to everyone else in the same circumstances. However, value capture applies to situations where taxpayers receive different benefits and aims to collect fees based on those differences. As a result, the jurisdiction must demonstrate that infrastructure projects supported by value capture revenues achieve uniformity by providing special, identifiable benefits to those paying the fees. Furthermore, fees must be proportional to the benefits received by the beneficiary or to the costs incurred in providing the infrastructure.

Avoiding Regulatory Takings

The Fifth Amendment to the U.S. Constitution limits the ability of the government to take private property. Such takings are subject to "due process," may only be undertaken for a "public use," and must provide "just compensation" to the owner. These requirements apply not just to physical takings, such as through eminent domain, but also regulations that affect the use and value of private property. Value capture fees may be perceived as falling into this category and

property owners may sue the government when they believe that a value capture technique has "taken" a property without providing just compensation.

Value capture returns to the public a portion of private value created through public infrastructure investment. By clearly identifying beneficiaries and demonstrating that value capture fees and payments are proportional to benefits received, value capture can avoid (or at least withstand) legal challenges related to regulatory takings.

THREE-PRONGED BALANCING TEST

The courts consider that a taking has occurred anytime "there is a physical invasion, no matter how small" or when "regulation denies all economically beneficial or productive use of land." In these cases, no further legal tests apply, and the agency must calculate the value of the taking and compensate the property owner in that amount. Most value capture does not involve physical takings, and instead the courts apply a three-pronged balancing test to determine whether a regulatory taking has occurred (*Agins v. City of Tiburon, 1980*). Under this test, the court considers:

- The economic impact of the regulation on the claimant.
- The extent to which the regulation has interfered with [the claimant's] distinct investment-backed expectations.
- The character of the governmental action.[2]

The "Essential Nexus, Rough Proportionality, and But-For Tests: State of the Practice" contains additional details about how the courts apply this three-pronged balancing test.

ESSENTIAL NEXUS AND ROUGH PROPORTIONALITY

Case law has established that even if the balancing test is satisfied, the jurisdiction must demonstrate:

- **Essential nexus.** This is a connection between the legitimate state interest and the government's action or policy (*Nollan v. California Coastal Commission, 1987*). Although "essential nexus" is language applied by courts about the validity of exactions, a similar concept is used for special assessments, whereby the assessing jurisdiction establishes a nexus between an infrastructure project and a special benefit conferred on a particular property or properties.
- **Rough proportionality.** The exactions or conditions placed on a property owner must be roughly proportional to the expected impacts (benefits) of the project (*Dolan v. City of Tigard, 1994*). The burden of proof lies with the jurisdiction. The jurisdiction must make an individual determination about proportionality for each burdened property, though precise mathematical proof is not required.

As a result, it is critical that the value capture sponsor demonstrate a clear nexus between a value capture-sponsored infrastructure and the benefits created by that infrastructure. Fee

[2] "Essential Nexus, Rough Proportionality, and But-For Tests: State of the Practice" (Federal Highway Administration), and Penn. Central Trans. Co. v. New York City, 438 U.S. 104, at 122 (1978).

levels must also be proportional to the benefits received or the costs incurred to create the benefit (proportionality) and may not exceed either the value of the benefit or the costs incurred in their creation.

Together, rational nexus and rough proportionality are often referred to as the Nollan-Dolan standard. Subsequent case law has determined that this standard applies to impact fees, exactions, and special assessments. Case law has also determined that the Nollan-Dolan standard applies to permits granted with onerous conditions as well as those negotiated or denied under onerous conditions (*Koontz* v. *St. Johns River Water Mgmt. Dist.*, 570 U.S. 595, 2013). Impact fees and negotiated exactions are two examples of value capture techniques that may be tied to building or occupancy permits and as a result could be subject to scrutiny under Nollan-Dolan.

Technique-Specific Considerations for Establishing Value Capture Boundaries

Beyond the legal tests discussed above are technique-specific considerations for ensuring that value capture boundaries target beneficiaries appropriately, as summarized in Table 1.

Table 1. Technique-Specific Considerations for Establishing Value Capture Boundaries

Value Capture Technique	Consideration
Special assessment districts	Special assessment districts are often used for infrastructure in localized "micro-service areas," which can be challenging to determine for open-system infrastructure such as roadways (versus closed system infrastructure such as wastewater treatment or a transit station). As a result, most have boundaries based on distance from the facility (e.g., mile rings or drive times), but it can be difficult to identify the distance-based metric that reflects the link between the project and beneficiaries accurately. Area-wide special assessment districts are sometimes used to support a transportation infrastructure program (rather than specific facilities).
Business improvement districts	The boundaries of a business improvement district should encompass a group of businesses with similar goals and priorities such as area marketing and promotion, public safety, or beautification (such as litter clean-up or landscaping).
Sales tax districts	A sales tax district is a type of special assessment district that captures value through sales tax rather than property value. As with other types of special assessment districts, benefit areas are often identified on the basis of distance from and access to the transportation facility. One key difference is that sales tax districts tend to encompass a larger area, such as an entire municipality, county, or corridor in multiple jurisdictions.

Value Capture Technique	Consideration
Tax increment financing (TIF) districts	Because TIF is not an additional tax or fee but rather a different way of allocating tax revenues collected post-project, it avoids many of the issues associated with regulatory takings. Nonetheless, identification of beneficiaries, and relating beneficiaries to level of benefits, is central to a successful TIF. This can be done by demonstrating that "but for" the public investment enabled by the TIF, private investment leading to increased property values (and the resulting property taxes collected) would not occur. State enabling legislation may allow (or require) TIF districts to be drawn to include blighted areas along with adjacent vibrant areas to use increment from the vibrant portion to help provide infrastructure that attracts development to the blighted portion. A common challenge is identifying a benefit area that is large enough to provide the revenue needed to fund the infrastructure but not so large that it captures tax revenues from development that would occur even without TIF funds. Another consideration is the possibility that developments enabled by TIF districts may create additional demands on other public infrastructure and services (schools, public safety, affordable housing) while the TIF is active, thereby segregating revenues from other taxing jurisdictions such as school districts or water/sewer districts. All impacts of the development enabled by the investment of TIF revenues should be considered so that undesired impacts can be avoided or mitigated. For example, the City of Lincoln, Nebraska, avoids impacts to its public school system by using TIFs to support residential development only in areas with excess school capacity (see N Street Protected Bikeway, Lincoln, Nebraska, case study). Jurisdictions can also exclude portions of property tax revenue collected by agencies with overlapping service districts from the tax increment calculation. This allows these public services to continue to receive property tax revenue at the same rate established pre-TIF, so that growth in revenue due to the infrastructure investment can be used to cover any increase in demand for services.
Developer impact fees	Boundary areas are often called "service areas," "overlay areas," or "beneficiary areas." Enabling legislation tends to allow jurisdictions broad discretion to define boundaries. Most state enabling legislation requires that the boundaries encompass the areas served by the infrastructure, and that fees collected from an area must be spent on infrastructure in that same area. Sometimes legislation allows the boundaries to include the entire jurisdiction, which is referred to as an "assessment area" because it represents the area where fees are assessed rather than the specific area served.

Sources: Value Capture: "Capitalizing on the Value Created by Transportation" (EDC-5 Implementation Manual), FHWA, August 2019; "NCHRP 873 Guidebook to Funding Transportation Through Land Value Return and Recycling (2018)", NCHRP Synthesis 459 Using the Economic Value Created by Transportation to Fund Transportation" and EBP.

How Agencies Design Value Capture Programs to Satisfy Key Legal Tests

Agencies use many tools to address the legal issues discussed above. For example, Pasco County, Florida, made provisions to its Multimodal Mobility Fee value capture program to withstand a two-prong rational nexus test. The first prong of this test is that there must be a reasonable connection between the proposed development and the need for the capital facilities to be supported by the value capture fees. The second prong is that there must be a reasonable connection between the expenditure of the funds collected and the benefits accruing to the development. This second prong also incorporates a standard for proportionality (i.e., that the benefits received are proportional to fees required).

The needs prong limited Pasco County to using the program revenue fir capital facility costs. It could not be used to fund operations and maintenance. This was problematic because the county's transportation network includes transit, and transit tends to be operation and maintenance intensive. Therefore, the program established a separate funding source—tax increment financing—to fund transit operations and maintenance. Although tax increment

financing is a form of value capture, it does not create a new tax or fee and therefore generally avoids the need to meet legal standards for rational nexus and rough proportionality.

Pasco County also faced the challenge of demonstrating a reasonable connection between the expenditures of the funds collected and the benefits accruing to the development. It was difficult to promote or provide a discount for compact, mixed-use development because all developments should be paying for the same needs (level of service), and fee differentials are generally based on trip generation. The agency was able to use California Department of Transportation's (Caltrans) studies to demonstrate that traditional neighborhood development (TND) and transit-oriented development (TOD) generate fewer vehicle miles traveled because more people are likely to walk, bike, or ride transit in those types of developments. TNDs and TODs often have greater density of destinations around transit stations, allowing households to spend less time commuting by car. For more information, see the Pasco County, Florida: Multimodal Mobility Fee Program case study.

The City of Chesapeake, Virginia, uses a form of negotiated exaction[3] called proffer whereby developers extend an offer of value to a jurisdiction in exchange for approval of a rezoning for development. Virginia's proffer system is enabled by state-level conditional zoning, which allows "reasonable conditions governing the use of such property, such conditions being in addition to, or modification of the regulations provided for a particular zoning district or zone by the overall zoning ordinance." Chesapeake's proffer program was designed to observe the enabling statute while meeting the legal standards discussed above to avoid causing uncompensated regulatory takings.

Although extending a proffer is a voluntary part of the application process, the requirement to meet infrastructure level-of-service standards is a compulsory part of the development proposal review process. Proffers may not include conditions required by the city for the subsequent subdivision or site plan review process. Furthermore, the city may accept only proffers to cover publicly maintained infrastructure, not for privately maintained facilities such as a development's internal signage or landscaping, and cannot assign responsibility for public facilities to a private entity such as a homeowner's association. The city attorney reviews all proffers before a rezoning application is approved to ensure compliance with state law and local policy. See Case Study: Elbow Road Widening Phases II & III Chesapeake, VA, for more information.

Texas law enables the creation of transportation reinvestment zones (TRZ), a form of tax increment financing aimed specifically at roadway transportation. As noted above, tax increment financing generally avoids the need to meet legal standards for rational nexus and rough proportionality because it relies on existing property tax rates and revenues. Nonetheless, as with all value capture, implementations must conform to enabling legislation. A key feature of Texas TRZs is the ability to establish benefits districts that cross municipal boundaries, but it also requires that TRZ districts be made up of contiguous parcels. The Camino Real Regional Mobility Authority, which serves the El Paso region, was the first agency in Texas to implement a TRZ. After the boundaries of the TRZ benefits area were established and the TRZ enacted, it

[3] Under the Uniform Act, negotiated exactions require thorough review when incorporated into a project using Federal Aid.

was discovered that two large government-owned parcels (Fort Bliss and Franklin State Park) were statutorily prohibited from inclusion. Removing these parcels would have created a noncontiguous TRZ, which would also violate the statute. As a result, this first TRZ was rescinded and the boundaries were redrawn as two separate TRZs, each made up of contiguous parcels that met statutory requirements. See Case Study: El Paso Transportation Reinvestment Zones for more information.

Conclusion

Transportation infrastructure generates economic activity by making new connections and/or by reducing transportation time and cost. These savings and new connections have value for households and businesses that use the new infrastructure. Value capture enables districts, neighborhoods, municipalities, counties, and states to direct a share of this publicly created value toward funding the infrastructure. In addition to the specific requirements set forth by value capture-enabling legislation, Federal, state, and local laws have established substantive and procedural requirements that may apply to value capture implementations. These requirements include due process, uniformity, essential nexus, and rough proportionality. Careful evaluation of the special benefits created by public infrastructure and the costs imposed by private development can help an agency design value capture implementations that satisfy the scrutiny of internal agency legal counsel and independent review by outside counsel. Examples from Pasco County, Florida, the City of Chesapeake, Virginia, and the Camino Real Regional Mobility Authority in El Paso, Texas, illustrate the different ways value capture implementations have addressed these legal issues.