

Midstate Economic Indicators

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Includes data from 1st quarter 2000

New Year, Old Trends

by Max Melnikov

Regardless of the notorious Y2K bug fears, the U.S. economy has stayed firmly on its growth track so far this year, and the midstate economy is no exception. The midstate leading index is up 1.3 percent in the first quarter of 2000 (Table 3), 0.2 percent higher than the corresponding U.S. index.

Residents of the middle Tennessee region enjoyed a near-record-low unemployment rate hovering around 3.2 percent in the second half of 1999 and for the first quarter of 2000. Our forecast calls for it to remain at that rate this quarter but inch up to 3.3 percent in the third quarter. The big contributor to the strong labor market picture has been the region's steady job growth rate. During the first quarter of this year, 14 new jobs were created for each existing 1000 jobs (Table 2). However, job growth remains centralized since job growth in Davidson and neighboring counties is significantly higher than the region's average. Along with the steady job growth, terminations have waned. Initial unemployment claims dropped by 2,785 or 10.6 percent from the fourth quarter of 1999.

Regional job opportunities lay mostly in the services area, with strong job growth noted in education, health services, other services, and government and gains also in construction and finance, insurance, and real estate (Table 1). The retail job picture is mixed, and weaknesses are evident throughout the manufacturing sector.

Middle Tennessee automobile and truck production dropped almost 10 percent, which is probably related to a pre-Y2K production buildup. That is, there was a very large production jump noted in the fourth quarter, and the first quarter's falloff is simply an offset. Air travel was also down (3.2 percent) from the previous quarter with no clear explanation other than the lingering effect of Opryland's closing. The weakness in air travel may be related to the quarter's employment drop in the hotel industry (Table 1). Nonetheless, the basic trend remains steady growth in most areas of the economy.

Looking ahead, the forecast model points

Table 1: Change in Employment 1999Q3 to 1999Q4 (Eight-County Nashville MSA)

Sector	Nashville MSA 2000Q1	Nashville MSA Change	Nashville MSA % Change*	USA % Change*
Total	672,638	11,114	1.7%	1.6%
Construction and Mining	33,325	73	0.2%	1.9%
Manufacturing: Transportation Equipment	15,131	-529	-3.5%	-2.9%
Manufacturing: Other Durable	43,627	721	1.7%	-0.4%
Manufacturing: Printing and Publishing	13,387	-310	-2.3%	-0.1%
Manufacturing: Other Nondurable	24,613	11	0.0%	-0.4%
Finance, Insurance, and Real Estate (FIRE)	42,501	136	0.3%	1.2%
Transportation, Communications, and Utilities	33,462	455	1.4%	2.9%
Wholesale: Total	38,321	-694	-1.8%	2.7%
Retail: Eating and Drinking	45,134	260	0.6%	-1.1%
Retail: Food	13,896	7	0.1%	0.3%
Retail: General	19,034	274	1.4%	-2.7%
Retail: Other	47,221	1,286	2.7%	3.6%
Services: Education	15,526	484	3.1%	2.5%
Services: Health	54,890	1,245	2.3%	1.2%
Services: Hotel	10,302	-89	-0.9%	0.9%
Services: Other	132,047	2,513	1.9%	4.9%
Government: Total	91,565	4,309	4.7%	1.9%

Sources: U.S. Bureau of Labor Statistics; MTSU. * Seasonally adjusted annual rate

to job growth nearly matching the growth in the labor force; in the third quarter, job growth is seen slowing a bit relative to labor force growth, which leads to the slight uptick in the unemployment rate. The model does not, however, factor in the recent job cuts announced by PaineWebber as it consolidates its acquisition of J. C. Bradford. On the positive

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Job growth in Davidson and neighboring counties is significantly higher than the region's average.

Table 2: Forecast Unemployment and Job Growth

	Actual			Forecast		
	'99Q2	'99Q3	'99Q4	'00Q1	'00Q2	'00Q3
Unemployment Rate						
Middle Tennessee	3.6%	3.1%	3.2%	3.2%	3.2%	3.3%
East Tennessee	4.2%	3.5%	3.6%	3.7%	3.6%	3.6%
West Tennessee	4.4%	3.7%	3.9%	3.9%	3.6%	3.8%
Tennessee	4.0%	3.4%	3.5%	3.5%	3.5%	3.6%
Job Growth: Four Quarter SAAR						
Nashville MSA	1.6%	1.3%	1.4%	1.4%	1.4%	1.2%
Chattanooga MSA	-0.1%	-0.4%	-0.4%	-0.3%	-0.2%	-0.1%
Tennessee	1.4%	0.9%	1.0%	1.1%	0.9%	1.1%

Sources: Bureau of Labor Statistics; MTSU
SAAR=Seasonally Adjusted Annual Rate

New Year

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side, the model does not take into account the recent opening of Dell's Davidson County manufacturing facility or Opry Mills. On balance, these latter factors will likely perpetuate the region's tight labor market conditions.

National developments are a wild card. The Federal Reserve is unswerving in its effort to slow the economy's growth pace in order to hold the line on inflation. With six increases in the federal funds rate in the last twelve months, weaknesses are now noted in both existing and new home sales, along with some evidence of weakness in consumer spending on durable goods. Even so, debate by market participants centers on when, not if, the Federal Reserve will increase its target for the federal funds rate. Any increase will pull other short-term rates up in tandem. The rise in those rates will prompt a corresponding increase in the prime rate, with effects felt on borrowing rates faced by small and mid-size firms as well as consumers whose borrowing rates are tied to the prime rate (e.g., variable-rate credit cards and home equity mortgage rates). Spillover effects would likely be felt on auto loan rates, and the equity markets would likely remain in the doldrums. All of this raises the risk of slower job growth in the second half of 2000. ■

Financing Middle Tennessee Growth

Development Impact Fees

by Douglas Timmons, MTSU finance professor

As new residents stream into middle Tennessee, cities and counties are spending millions of dollars to provide infrastructure improvements necessary to accommodate growth. New schools, sewers, roads, parks, and other public amenities must be built. How to finance these projects has become a major concern for all of the fast-growing areas around metropolitan Nashville.

Our region, like many others around the country, has increasingly used development impact fees (DIFs) to finance capital and infrastructure requirements mandated by residential growth (Table 4). DIFs are charges assessed against newly developing property that attempt to recover some or all of the cost incurred by a local government in providing the public facilities required to serve the new development. Most of the local fees are not technically "impact" fees because they are not truly based on the impact associated with a particular development. In spite of the general acceptance of DIFs, many public officials,

Table 3. Data Bank for Middle Tennessee

Series (adjusted for seasonality and inflation)	Geographical Area	'99Q3	'99Q4	'00Q1	'99Q4-'00Q1
COMPOSITE INDICES					
Midstate Leading Index	Midstate (41 Counties)	106.35	107.53	108.93	1.3%
U.S. Leading Index	U.S.	111.73	112.97	114.23	1.1%
EMPLOYMENT					
Midstate Number of Employed Persons	Midstate (41 Counties)	1,035,703	1,036,045	1,036,455	0.0%
Midstate Unemployment Rate	Midstate (41 Counties)	3.1%	3.2%	3.2%	0.0%
Percent of Sectors with Employment Increase for Month	Nashville MSA (8 Counties)	52%	52%	50%	-3.8%
Percent of Counties with Employment Increase for Month	Midstate (41 Counties)	54%	46%	44%	-4.3%
Average Hours Worked per Week in Manufacturing	Nashville MSA (8 Counties)	40.19	40.29	40.48	0.5%
Average Pay per Hour in Manufacturing	Nashville MSA (8 Counties)	13.44	13.56	13.67	0.9%
INITIAL CLAIMS AND BANKRUPTCY					
Initial Claims for Unemployment Compensation	Midstate (41 Counties)	28,242	26,350	23,565	-10.6%
Bankruptcy Case Filings	Midstate (41 Counties)	2,709	2,742	2,788	1.7%
REAL ESTATE					
Occupancy Index	Davidson County	98.01%	97.98%	97.77%	-0.2%
New Residential Units (permits)	Midstate (41 Counties)	3,576	4,170	4,363	4.6%
Value of New Residential Units (million \$)	Midstate (41 Counties)	386.7	388.8	400.9	3.1%
AUTOMOBILE PRODUCTION					
Autos Assembled in U.S.	U.S.	3,307,629	3,289,163	3,010,698	-8.5%
Autos Assembled in Midstate	Midstate (41 Counties)	153,173	177,091	159,708	-9.8%
Units Sold: Autos Assembled in Midstate	U.S.	131,389	141,796	131,810	-7.0%
TOURISM					
Hotel Revenue	Davidson County	92,784,136	97,685,900	98,587,665	0.9%
Air Passengers	Davidson County	2,146,250	2,101,001	2,033,252	-3.2%
INCOME, EARNINGS, AND RETAIL SALES					
Retail Sales (million \$ per quarter) *	Midstate (41 Counties)	—	—	—	—
Total Personal Income (annual billion \$)	Midstate (41 Counties)	52.6	52.9	53.2 (est.)	0.6%
Earnings per Resident Worker (annual)	Midstate (41 Counties)	36,553	36,455	36,757 (est.)	0.8%

Notes: Seasonal adjustment with X11-ARIMA; not annualized; dollars converted to '99Q4 prices with GDP implicit consumption deflator. * Insufficient data.

Sources: U.S. Department of Labor, Bureau of Labor Statistics; Tennessee Department of Employment Security; Nashville Electrical Service; U.S. Bureau of the Census; *Automotive Weekly*; Metropolitan Nashville Government; Nashville Airport Authority; Tennessee Department of Revenue; U.S. Bureau of Economic Analysis

developers, and citizens still do not understand the basis for impact fees.

In a related area, the Tennessee State Legislature is considering legislation that would permit at least 15 high-growth counties to levy a real estate transfer tax with proceeds allocated to new school construction. A two-thirds vote by county commissioners would be required to enact the new tax in the designated counties.

The state already imposes such a tax (37 cents per \$100): the transfer tax collected every time a house changes hands. The Tennessee Municipal League, which represents the interest of cities, has spoken out against the proposed tax. Many cities are charging “development” and “adequate facilities” taxes which the tax bill would phase out over a 10-year period.

Development Impact Fees—Why Now?

Several factors working in concert have caused the expanded use of DIFs. There has been a substantial reduction of federal spending on local public-works projects in recent years, and the shortfall must be made up by state or local governmental agencies. Changes in technology have increased the sophistication of public-works projects, increasing costs and eroding the financing ability of public agencies. Substantial changes in environmental regulation and the costs of compliance have further strained budgets. Our population is more educated, sophisticated, and likely to express demands and desires for better public facilities to elected officials than ever before, resulting in greater costs associated with public projects. All of these factors lead to the greater expense of public projects today. Add in some inflation and the fact that our area is growing very rapidly, and it is obvious that more dollars are required to provide the infrastructure needed to support our citizens.

Paying for neighborhood amenities is a problem of particular concern to suburban communities, where population growth has been rapid and preexisting infrastructure is often lacking. The counties surrounding Nashville have grown as families have sought moderately priced housing and a balance between access to the central city and the neighborhood standard of living they desire. An initial impetus for suburban growth was provided by improvements in the interstate highway system. More recently, movement to outlying areas has been fueled by efforts to find relief from the high crime rates and weaker education systems of urban areas.

Are DIFs Fair?

Philosophical discussions on the need for impact fees and their effect on the economy of the community may continue indefinitely. However, the rationale for charging impact fees is based on the premise that new development should pay the cost associated with growth. Conversely, the existing residents should bear only the costs of improving existing services.

The real issue is growth and who should pay for it. Citizens may not want growth, legitimately fearing that their quality of life will diminish as their town or countryside is transformed into new housing developments and that higher property taxes for new schools, sewer lines, and roads will only benefit others. If they see and feel traffic congestion, economic impact that only benefits others (this may be particularly true for the retired), and higher taxes, why would they favor growth? High development fees would seem appropriate as a means to slow growth or pass its cost on to the newcomers.

To the extent that DIF financing of infrastructure replaces the property tax, it shifts payment from owners of existing property to parties associated with newly developing property. Impact fees are passed on to new homebuyers in the form of higher prices or reduced choice of size, location, and amenities. Due to the incentives facing policymakers and

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The rationale for charging impact fees is that new development should pay the cost associated with growth and existing residents should bear only the costs of improving existing services.

Table 4. Middle Tennessee Development Impact Fees

COUNTY/City	Tax	When Started	Revenue	Revenue Allocation
BEDFORD	None	NA	NA	NA
CHEATHAM	Development tax \$7500 per residence as of August 17, 1999. Tax created May 1997 at \$750 per residence. Raised to \$2740 in April 1999.	May 1997	Fiscal Year 1998/1999: \$975,154	Public services Schools
COFFEE	None	NA	NA	NA
DAVIDSON/ METRO	None	NA	NA	NA
DICKSON	None, discussing	NA	NA	NA
MAURY	Adequate facilities tax \$.50 per sq. ft. for residential. \$.30 per sq. ft. for commercial	Jan. 19, 1999	1999: \$861,199	Capital improvements, including schools Public services
Spring Hill	Impact fee \$500 + \$.25 per sq. ft. for residential and commercial April 1994 \$.30 per sq. ft. for commercial	April 1994	\$365,000	Public services
MONTGOMERY	None, discussing	NA	NA	NA
ROBERTSON	Adequate facilities tax \$1 per heated sq. ft. for residential	Jan. 1, 1997	Fiscal year 1999: \$811,500	Schools
RUTHERFORD	\$750 Development tax \$375 for residential unit \$375 for residential lot	July 1996	Fiscal year 1999: \$2,472,375	Capital improvements
Smyrna	\$1232 for residential unit; commercial varies	Dec. 1999	Jan-April 2000 \$79,585	Roads, fire services, parks Schools
SUMNER	Adequate facilities tax \$.70 per sq. ft. for residential; \$.40 per sq. ft. for industrial	Nov. 1, 1999	1999: \$140,823 12 months to date: \$545,179	Schools
White House	Impact tax varies \$1,245 for residential; \$494-\$8,141 per 1,000 sq. ft. for commercial development	1996	1999: \$1,141,454	Services, including roads, parks, police, and fire
WILLIAMSON	Privilege tax \$.90 per sq. ft. for residential; \$.34 per sq. ft. for commercial Within cities: \$.68 per sq. ft. for residential; No county tax for commercial	1985	Fiscal year 1998-1999: \$4,368,046	Residential: schools and recreation; commercial and part of residential fees collected outside of cities: fire services and highways
Brentwood	Public Works project fee \$598 for residential; commercial varies	1987	1999: \$598,078	Public works and transportation improvements
Franklin	Facilities tax \$.46 per sq. ft. for residential; \$.77 per sq. ft. for commercial Road impact fee \$425 per house for residential; commercial varies	1988	1999: \$2,266,019	Public services
WILSON	None	NA	NA	NA
Lebanon	Water/sewer capacity fee \$250/single family unit-water \$500/single family unit-sewer	Oct. 1987	Fiscal year 1999: \$180,752	Water and sewer Works
Mt. Juliet	Development fee \$.50 per sq. ft. for residential with \$1,250 sewer capacity fee,	Spring 1998	1999 \$160,000	Parks and roads

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**Perhaps our real concern
should be related
to the long-term
implications for job
growth, environment,
quality of life issues,
and housing mix.**

Financing

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the lack of accurate information on the cost of new development, impact fees are unlikely to reflect the true cost of public services or infrastructure. High impact fees are regressive, reduce the supply of moderately priced housing, and may negatively affect a community's ability to attract and retain high-paying jobs.

When municipalities adopt DIFs, all other things being equal, developers will be willing to sell less housing at any given price since they must recover their production cost plus the cost of the fee. This means higher prices for housing in the community charging the fees or changes in the type and location of new housing.

Where developers are unable to pass along fees to homebuyers directly, they may build in areas with lower fees even though such areas are less suited to commuting patterns and community planning or build larger and more expensive homes to recover the fees through higher margins. These activities impose indirect, but still significant, costs on taxpayers, commuters, and homeowners.

Impact fees hurt people with modest incomes in two ways. First, if the fee is the same whether the new home is priced at \$100,000 or \$500,000, the fee requires a larger

percentage increase in the sale price of lower-priced than higher-priced homes. Second, builders are most likely to respond to high impact fees by reducing the supply of moderately priced housing, since fees are usually added to the cost of the lots they build on and the size and amenities of new homes are often chosen to justify a sales price of between three and four times the cost of the lot.

Conclusion

The increasing use of DIFs represents a trend in local fiscal policy that can affect real estate markets. The ramifications for economic efficiency and the pattern of metropolitan area development are not well understood by urban planners, real estate developers, or academics. Current discussion focuses on who bears the burden of the fees. Perhaps our real concern should be related to the long-term implications for job growth, environment, quality-of-life issues, and housing mix. Middle Tennessee is a growth area. How we plan for continued growth and balance growth with the quality of life we desire is the key issue. County and city administrators need to forecast growth, formulate the true cost of development, and if impact fees are to be assessed, fairly partition the cost of growth in an appropriate way. Arguments over development impact fees are part of the greater debate over urban sprawl. ■